

**BEA securities**

EAST ASIA SECURITIES COMPANY LIMITED

8/F, 10 Des Voeux Road Central, Hong Kong.

Dealing: 2842 3530 / 2842 3475 Research: 2842 3198 Facsimile: 2845 2937 / 2526 7992

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Analyst: Kelvin Li

Main Board Listing - Research

中國神威藥業集團有限公司

China Shineway Pharmaceutical Group Limited [Stock Code: 2877]**Global Coordinator and
Bookrunner**

: Cazenove Asia Limited

Sector : Pharmaceuticals**Business** : Development, manufacture and sale of modern Chinese medicines, production and sale of a series of western pharmaceuticals

Total share offer: <u>200,000,000</u> shares (25% of the enlarged share capital) Public Offer: 20,000,000 shares (10%) Placing: 180,000,000 shares (90%) Greenshoe: 30,000,000 shares	<u>Business of Shineway</u> Shineway is one of the leading non-state-owned Chinese medicine enterprises in the PRC. The Group is mainly engaged in the development, manufacture and sale of modern Chinese medicines and also produces and sells a series of western pharmaceuticals. As of 30 th June 2004, the Group had a range of 31 prescription and 14 OTC medicines. Since then, the Group obtained OTC registration for another 7 prescription medicines and could be sold in retail pharmacies. Besides, the Group has received production approvals for 180 other pharmaceuticals. The Group currently produces 45 medicines regularly, which are mainly focused on the treatment of diseases commonly affecting middle and old aged people and/or children, including cardiovascular diseases, respiratory system diseases, colds and fevers and problem of digestive system; or anti-viral treatment. The Group has established an extensive sale and marketing network covering 30 provinces and municipal cities in the PRC with a particular strength in northern and central China.
Price: HK\$3.70 – HK\$4.36 per share Market Cap.: HK\$2,960 million – HK\$3,488 million Forecast FY2004 P/E: 12.8x – 15.0x (pro forma fully-diluted) Adjusted NTA per share: HK\$1.09 – HK\$1.26 Staffing: 1,456 (as of 31 st December 2003)	
HK Public Offer period: 23 rd November 2004 - 26 th November 2004 Receiving bank: Standard Chartered Bank (HK) Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 2 nd December 2004	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Sinovest

75%

75%

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$690 million

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$3.70 each, which is the lowest end of the indicative price range)

	HK\$ million
Expanding sales and marketing network	244
Expanding and upgrading production capabilities	210
Strengthening research and development capabilities	82
Upgrading information management and logistics systems	71
Enhancing relationships with suppliers and production bases	16
General working capital	67

Financial Highlights

	6 months ended 30 th June 2004	Year ended 31 st December		
	RMB in million	2003 RMB in million	2002 RMB in million	2001 RMB in million
Turnover	336.5	604.0	477.9	430.9
Operating profit / (loss)	161.2	185.1	126.3	109.0
Net profit / (loss)	146.1	151.4	77.4	71.7
EPS	RMB0.24	RMB0.25	RMB0.13	RMB0.12

Breakdown of Turnover by Product Types

	6 months ended 30 th June 2004		Year ended 31 st December					
	RMB in million	%	2003 RMB in million	%	2002 RMB in million	%	2001 RMB in million	%
Prescription								
- Modern Chinese Medicines	267.2	79.4	431.8	71.5	321.7	67.3	280.2	65.0
- Western pharmaceuticals	47.4	14.1	79.3	13.1	77.2	16.2	72.4	16.8
OTC								
- Modern Chinese Medicines	20.2	6.0	68.4	11.3	51.8	10.8	51.5	12.0
- Western pharmaceuticals	1.7	0.5	24.5	4.1	27.2	5.7	26.8	6.2
Turnover	<u>336.5</u>	100.0	<u>604.0</u>	100.0	<u>477.9</u>	100.0	<u>430.9</u>	100.0

Strengths/Opportunities

- ✓ The Group's principal brand "SHINEWAY" is one of the well-known brand names in China, recognized as a China Famous Trademark and a China Famous Brand Product by market agencies. A strong and positive reputation should help the Group market its new products and promote quick market acceptance.
- ✓ The Group has a portfolio of 45 modern Chinese medicines and western pharmaceuticals under regular production, which are mainly for treatment of common ailments and diseases affecting the middle and old aged and/or children. A well-diversified portfolio should help minimize product risks and enhance economies of scale.
- ✓ The Group employs a market driven approach to partner with research institutions, universities and hospitals in carrying out R&D projects. It enables the Group to benefit from research partners' expertise and resources and makes R&D become more cost efficient.

- ✓ According to latest data from WHO, total expenditure on health per capital in China is only 1.0% to that in the US, 1.9% to that in Japan and 22.1% to that in Brazil. Therefore, it remains huge room for development of the pharmaceutical sector in the PRC.

Weaknesses/Threats

- × According to the *China Medical Statistical Yearbook 2003*, there were a total of 1,364 Chinese medicine-manufacturing companies in China at the end of 2003. The sector was highly fragmented with the top ten players sharing a market share of less than 20%. Therefore, one could expect keen competition in the PRC's pharmaceutical sector in the future.
- × Some of the Group's products are subject to national price control by relevant authorities. As a result, these products could not be sold at above prescribed retail prices. In FY2003 and 1H2004, these products accounted for 51.5% and 56.9% of total turnover, respectively.
- × Cost of raw materials and supplemental materials have been rising in line with larger sales in the last couple of years, resulting higher COGS; For the year ended 31st December 2003, raw material cost rose 39% y-o-y to HK\$197.5 million. However, for the six months ended 30th June 2004, raw material cost only amounted to RMB47.5 million, just 24% of that in 2003. Lower raw material cost and so lower COGS helped boost the gross profit margin in 1H2004 to 65%, compared with 52% in 1H2003 and 48% in FY2003. However, it is hard to say whether low raw material cost could sustain in the second half as well as in the coming years.
- × Despite falling trade receivable turnover (days) in FY2003 and 1H2004, the Group's trade and other receivables still stood at uncomfortable level of RMB112.1 million, much higher than those in the previous years. (2003: RMB62.9 million; 2002: RMB94.2 million)
- × The management does not guarantee any dividend payout ratio in the future.
- × In terms of valuation, shares of Shineway would be priced at between 12.8x-15.0x FY2004E P/E, close to peer Tong Ren Tang Technologies' (8069) consensus 15x FY2004E P/E but more expensive than Guangzhou Pharmaceutical's (0874) 10x FY2004E P/E. However, Tong Ren Tang has a clear track record of stable dividend payout and makes it more appealing to the counter. Therefore, the counter's valuation could be regarded as slightly demanding when compared with its HK-listed peers.

Recommendation: Unappealing