

# China Keys

## China healthcare: where to position for growth

### Equities

China  
Healthcare

#### Long-term growth supported by demographic change and industry drivers

The healthcare sector should be a key beneficiary of China's changing demographic that includes an aging population and urbanisation. We view the rising incidence and detection of diseases as powerful growth drivers alongside improving affordability supported by the expansion of medical insurance and growth in government health care expenditure, which we expect to rise from c5.0% in 2011 to 6.5-7.0% of GDP by 2020 (Figure 2). At the industry level, greater innovation should benefit growth and we expect acceleration in consolidation of highly-fragmented sub-sectors.

#### MMA to open up China A-share opportunities

Mutual Market Access (MMA) between Shanghai and Hong Kong will allow overseas investors greater access to the attractive themes supporting China healthcare. Thirty-nine healthcare companies are eligible for northbound trading, with a market cap of over US\$90bn and with 9x the liquidity of Hong Kong/US-listed healthcare companies. The MMA healthcare sector includes many high-quality companies with competitive product portfolios as well as diverse sub-sectors and unique areas like traditional Chinese medicine (TCM).

#### We favour TCM, services and device companies and biological drug makers

We believe that sub-sectors with scarcity value outside of the A-share market will benefit from MMA, and we favour sub-sectors with good fundamentals and long-term growth prospects. Our preferred picks are: Traditional Chinese Medicine (Kanion Pharma (600557.SS) and Yibai Pharma (600594.SS)); healthcare services (Fosun Pharma (2196.HK/600196.SS)); medical devices (Shinva Medical (600587.SS)); and biological drug makers (Tonghua Dongbao (600867.SS)).

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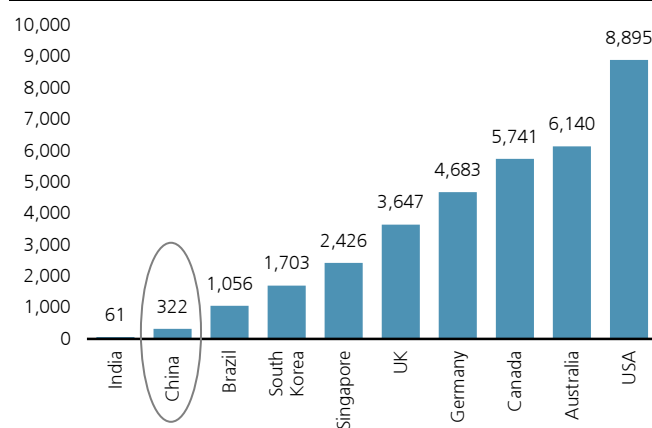
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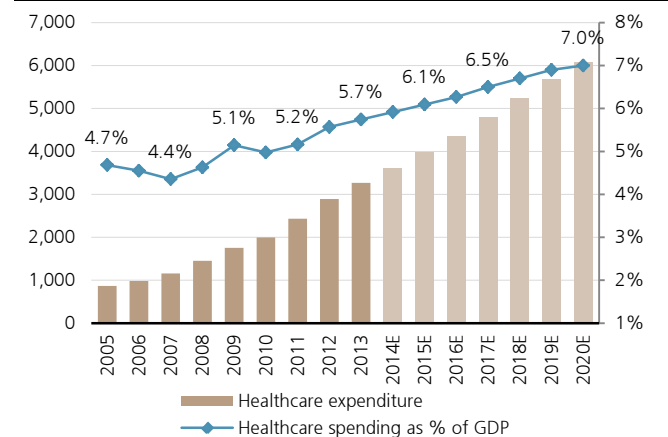
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**Figure 1: Healthcare expenditure per capita (2012, US\$)**



Source: The World Bank

**Figure 2: China's total healthcare expenditure (Rmb bn)**



Source: National Statistics Bureau, UBS-S estimates

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*As we approach the launch of the Hong Kong/Shanghai Mutual Market Access (MAA) program, the UBS China Keys series will focus on the key themes and major issues that UBS Global Research expects to shape the future of Chinese equity markets. These views and insights are drawn from collaborative research that utilises our offshore team & our A-share research team based in Mainland China.*

# Investment Thesis

The healthcare sector should be a key beneficiary of demographic change in China, including an aging population, urbanisation and increasing affordability. We believe that these trends will continue to drive strong growth in the healthcare sector and therefore the sector is likely to be attractive for foreign investment. The introduction of Mutual Market Access (MMA) between Shanghai and Hong Kong opens up opportunities for international investors in the China A-share market (please see our recent reports, [MMA Primer China A Shares – Get Connected](#), Matthew Gilman, published 24 July 2014 and *The 50 MMA eligible stocks that we favour*, *China A-Share Strategy*, Li Chen, published 24 July 2014.) MMA will enable overseas investors to access 39 healthcare A shares, including unique sub-segments such as Traditional Chinese Medicine (TCM) that are currently not available outside the A-share market. In this report, we outline our favoured sub-sectors, stock ideas and the key drivers of growth in the China healthcare sector.

## A beneficiary of aging and attractive industry growth drivers

The aging population of China has come into focus in recent years and will be a challenge as the economy adjusts to the loss of the 'demographic dividend': tighter labour supply; changing consumption patterns; and a higher financial burden on healthcare expenditure and pension funds. While many other domestic sectors face the negative consequences of this trend, we expect the rise in the number of elderly will spur both government policy/reform and corporate sector developments, which should be positive for the long-term growth of China's healthcare sector.

More specifically, urbanisation and associated lifestyle changes should lead to an increase in the prevalence of major chronic diseases. Affordability should rise supported by total expenditure on healthcare increasing from 5.0% to 6.5-7.0% (including government, social and individual out-of-pocket payments) of GDP in 2020, according to the China Healthcare and Family Planning Committee, and the expansion of medical insurance. Industry consolidation of China's highly fragmented sub-sectors is likely to accelerate, supported by favourable regulations, and the more innovative nature of Chinese pharma stocks should support further growth.

## MMA to open up new investment opportunities

The likely introduction of MMA in October will give international 'northbound' investors more opportunities to invest in the attractive themes supporting the China healthcare sector that we outline in this report. As Figure 3 shows, for investors who had previously only considered H-share stocks, the MMA-eligible A-share universe will provide access to over twice as many healthcare stocks with a significantly bigger market cap and far higher liquidity. The MMA universe includes 28 stocks that exceed US\$1bn in market cap (vs. just 18 H shares) and 31 stocks with a daily trading volume of over US\$10m (three H shares).

**Figure 3: Snapshot of A share vs. overseas listed China healthcare companies**

Listed country	No. of companies	Market cap (US\$ bn)	Daily volume (US\$ m)	Average 2014E PE	Average 2015E PE
China – A-shares	~170	250+	2,500+	37x	27x
MMA HC companies	39	90+	800+	23x	19x
HK	33	70+	90+	23x	18x
<b>Total/ Average</b>	<b>200+</b>	<b>310+</b>	<b>1,700+</b>	<b>n.a.</b>	<b>n.a.</b>

Note: We excluded the China healthcare (HC) companies with market cap less than US\$100m (same rule for all the following tables); 2) average PE for MMA and HK-listed China HC stocks is based on a weighted average methodology (stocks without net profit forecast are excluded from the calculation); 3) average PE for total A-share China HC stocks are simply averaged PE extracted from Bloomberg/Wind. Source: Bloomberg, Wind, as of August 15, 2014.

In our view, the MMA healthcare sector includes many high-quality companies with competitive product portfolios, strong R&D capabilities, robust product pipelines, strong sales forces and quality management. Several are leaders of their respective sub-sectors, eg, Hengrui Pharma (600276.SS) and Tasley (600535.SS).

The diversity of the sub-sectors within the MMA healthcare universe and the uniqueness of certain sub-sectors compared to the existing H-share universe are we believe both positives. For example, exposure to the TCM sub-sector is not possible in the H share market, but there are 13 TCM companies in the MMA healthcare sector.

**Figure 4: MMA China healthcare companies by sub-sector**

Sub-sector	No. of companies	Market cap (US\$ bn)	Daily volume (US\$ m)	Average 2014E PE	Average 2015E PE
Pharmaceuticals	19	c50	400+	21x	17x
TCM	13	25+	300+	26x	20x
Biotechnology	2	c4	35+	37x	30x
Healthcare Service	4	c8	~50	28x	23x
Medical Device	1	2+	15+	39x	28x
<b>Total/ Average</b>	<b>39</b>	<b>90+</b>	<b>800+</b>	<b>23x</b>	<b>19x</b>

Source: Bloomberg, Wind, as of August 15, 2014.

Our preferred subsectors (and associated preferred stocks) are: TCM (Kanion Pharma (600557.SS) and Yibai Pharma (600594.SS)); healthcare services (Fosun Pharma (2196.HK/600196.SS)); medical devices (Shinva Medical (600587.SS)); and biological drug makers (Tonghua Dongbao (600867.SS)). Please see the company pages for the individual investment thesis.

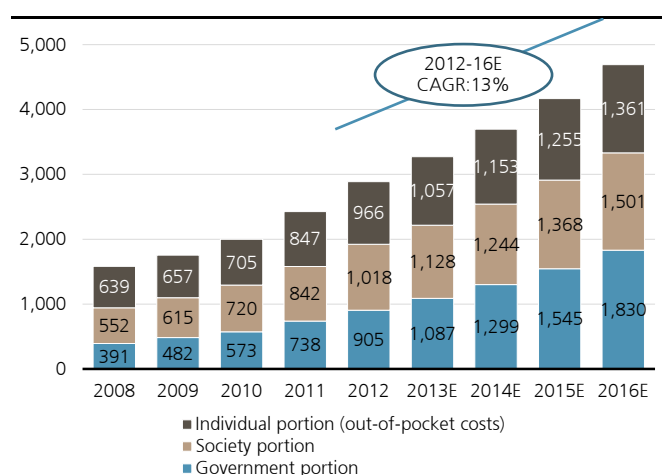
# Industry overview

## Robust long-term growth prospects

According to the China Healthcare and Family Planning Committee (CHFPC), total healthcare expenditure in China was Rmb2.8trn in 2012, comprising government (30%), society (corporations, and other social institutions who bear healthcare expenditure, 36%) and individual out-of-pocket payments (34%).

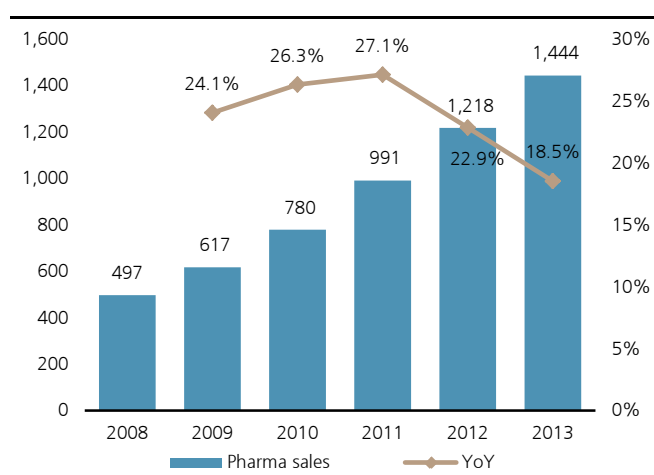
The pharmaceutical sector is the biggest in the China healthcare industry, accounting for more than 40% of total expenditure. The sub-sector recorded revenue of around Rmb1.4trn in 2013 at a CAGR of 23.8% from 2008-13, according to CEIC. Other major sectors include medical devices & consumables and healthcare services.

**Figure 5: Total healthcare expenditure in China (Rmb bn)**



Source: CFPHC, UBS-S estimates

**Figure 6: China pharma sector revenue (Rmb m, 2008-13)**



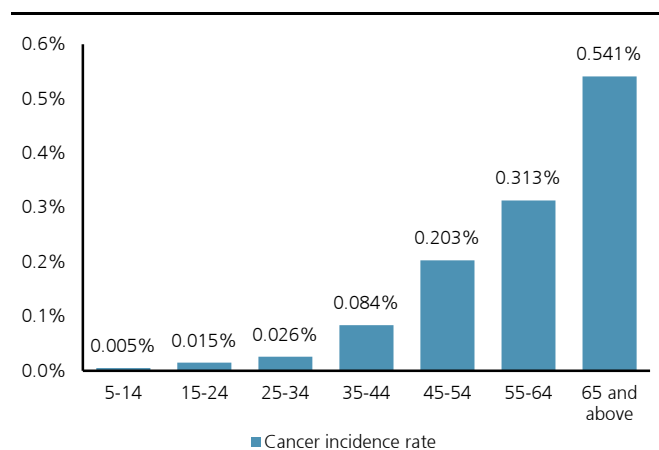
Source: CEIC

Despite drug pricing and insurance payment pressures, and policy uncertainties we expect China's healthcare sector to offer strong long-term growth based on: 1) the rising incidence (and detection of disease) driven by demographic, urbanisation and lifestyle changes; 2) increased affordability of healthcare; 3) consolidation within sub-sectors; and 4) innovation.

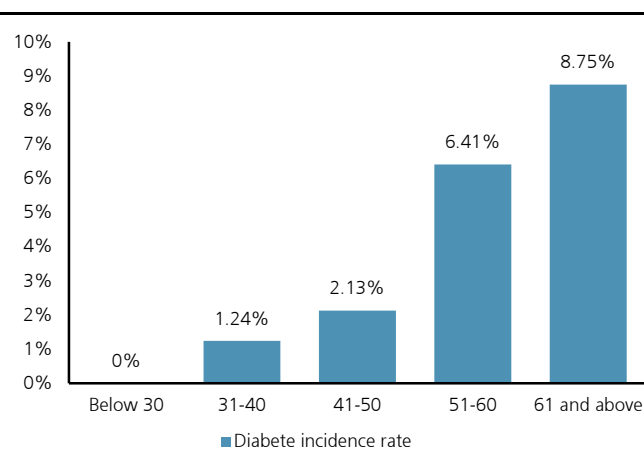
## 1. Rising incidence and detection of disease

### Aging drives higher rates of major chronic disease

China is undergoing a continued and accelerating trend of population aging. According to Euromonitor International, the percentage of people 65 years old and above will increase to 14.4% of the total population in 2017 from 11.1% in 2012. This implies an increase of 40m compared to just a 20m increase from 2008 to 2012. A rapidly aging population is directly associated with a rise in the incidence of many chronic diseases including cancer, cardiovascular and cerebrovascular diseases (CCV diseases), and diabetes.

**Figure 7: Cancer incidence rate among age groups**

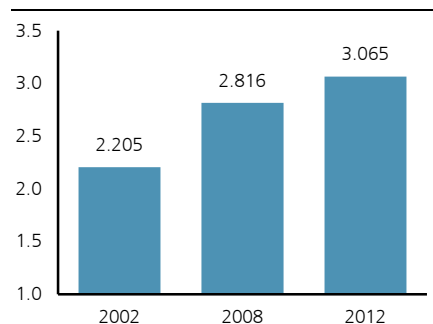
Source: CHFPC

**Figure 8: Diabetes incidence rate among age groups**Source: Sample based statistics published in *Experimental & Lab Med* (Dec-2008)

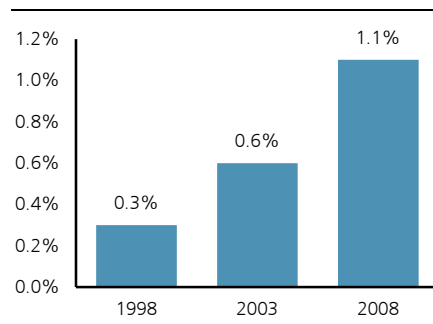
### Lifestyle change leads to increased rates of major chronic diseases

Along with rapid economic growth and industrialisation, the steady rise in urbanisation has been a clear trend over the past two decades. The urban population increased from 624m in 2008 to 731m in 2013, with the urbanisation rate rising from 47.0% to 53.7% in the same period, according to the National Statistics Bureau. We believe lifestyle changes associated with urbanisation lead to an increase in the prevalence of major chronic diseases including cardio-cerebrovascular diseases and diabetes.

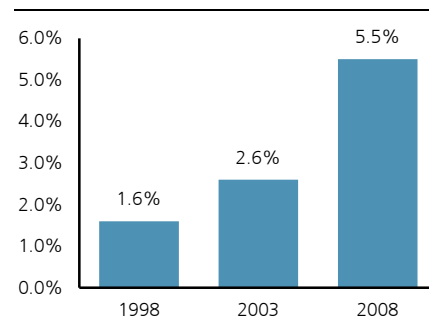
Healthcare spending by urban residents accounted for over two thirds of total healthcare spending in China in 2012, according to the National Health Care and Family Planning Committee (NHFPC), indicating that per capita spend by urban residents is around three times higher than rural residents. Rising urbanisation will continue to support increased rates of detection, in our view, as urban citizens have greater access to healthcare services.

**Figure 9: Newly reported cancer cases in China (m)**

Source: Globocan

**Figure 10: Diabetes prevalence rate in China**

Source: CHFPC

**Figure 11: Hypertension prevalence rate in China**

Source: CHFPC

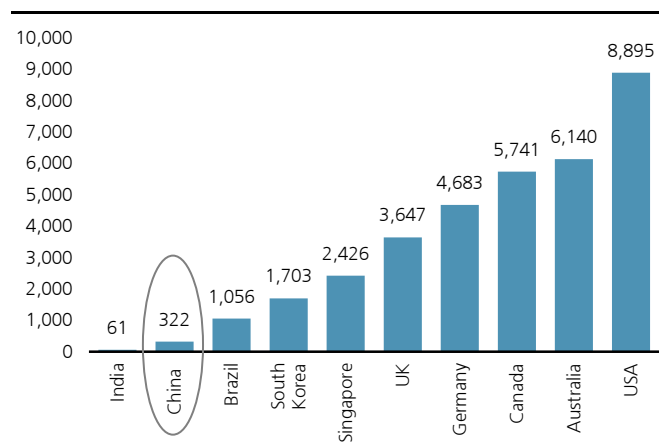
## 2. Increased affordability of healthcare

### Rising government expenditure on healthcare

Government expenditure on healthcare has historically lagged overall economic growth. However, in line with the "Healthy China 2020 Strategic Research" report, the Ministry of Health (MOH) expects national healthcare spending to account for 6.5-7.0% of China's GDP in 2020, up from c5% in 2011. This implies an increase in total healthcare spending to as much as Rmb6-7trn by 2020, or 2.5x

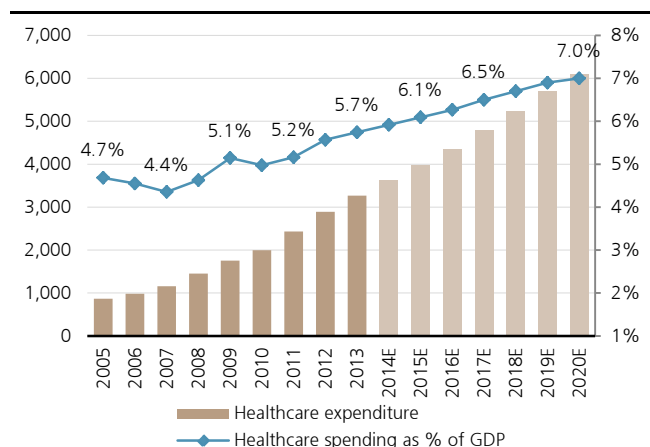
the current amount. We believe higher government spending will result in increased investment in improving the accessibility and affordability of healthcare.

**Figure 12: Healthcare expenditure per capita (2012, US\$)**



Source: The World Bank

**Figure 13: China's total healthcare expenditure (Rmb bn)**



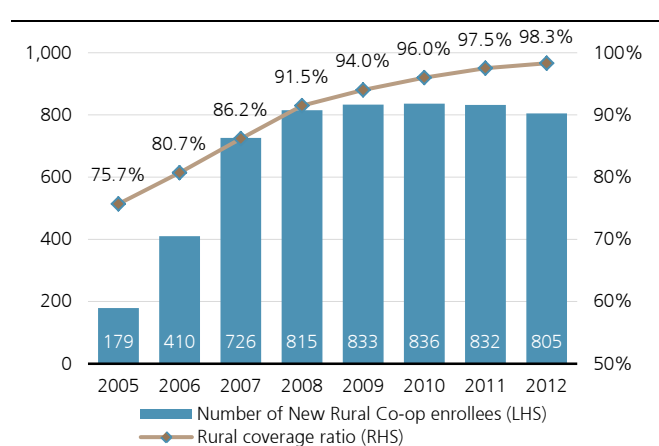
Source: National Statistics Bureau, UBS estimates

### Expansion of medical insurance significantly improves affordability

We believe the expansion of basic medical insurance coverage has materially improved affordability of healthcare services and products, as reflected in the improvement in patient volume growth and the treatment rate. As of 2012, over 96% of the Chinese population had basic medical insurance coverage.

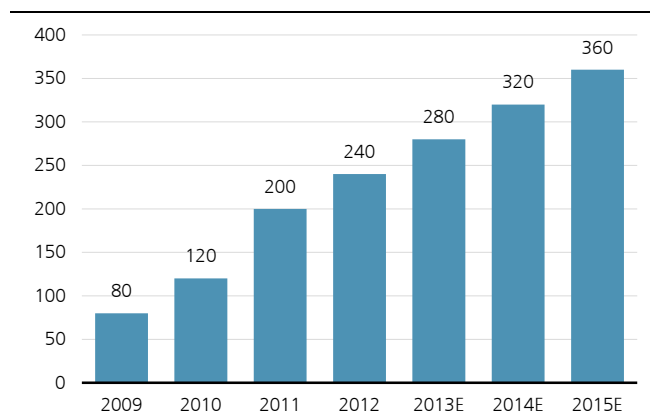
While we are close to the end of medical insurance coverage expansion, we expect the government to continue to increase the per-capita medical insurance subsidy and optimise the use of medical insurance funds, which should further drive the affordability of healthcare products/services.

**Figure 14: Rural medical insurance coverage**



Source: NHFPC

**Figure 15: Government subsidy on new rural co-op and basic medical insurance for urban residents (Rmb bn)**



Source: NHFPC, UBS

### 3. Consolidation within sub-sectors

#### Consolidation should provide upside in highly fragmented sub-sectors

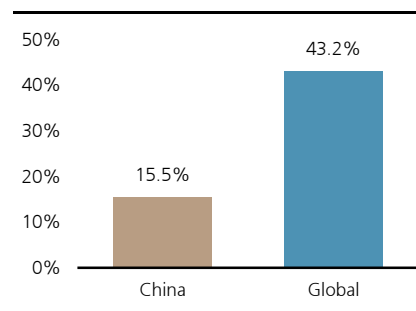
Due to the historical dominance of provincial and local government ownership, the China healthcare sector is highly fragmented and we expect considerable growth opportunities for companies that can act as consolidators.

For example, there are around 5,000-6,000 pharmaceutical manufacturers in China, according to the China Food and Drug Administration (CFDA). The top-10 drug manufacturers only have a 15.5% market share. In contrast, 43.2% of the global drug market is in the hands of the top-10 global pharma manufacturers, according to IMS.

Other sub-sectors such as medical device manufacturers and pharmaceutical distributors display similar characteristics: a high number of competitors with low market share concentration.

Industry consolidation is a powerful trend in the healthcare sector and we think it will result in market leaders reaping material benefits both in the short term (eg, though lower regulatory risk and costs, avoidance of value-destroying price competition) and in the longer-term through higher retained profits, which can fund R&D to support longer-term growth.

**Figure 16: Market share of top-10 pharma manufacturers in China vs. global companies (2011)**



Source: IMS

**Figure 17: Market size and competitive landscape among China healthcare sector**

Subsector	Market size	No. of Co.	Market share by Top Co.
Chemical Drug	Rmb330bn	~6,000	Top 10 market share 15.5% in 2011, according to IMS
Biological Drug	Rmb180bn		
TCM	Rmb500bn		
Medical Device & Consumable	Rmb170bn	>10,000	Top 30 co. accounts for ~27% of total sector sales
Distribution/Retail	Rmb1,300bn	~13,000	Most of them are small. Top 10 co. accounts for ~48% of total sales

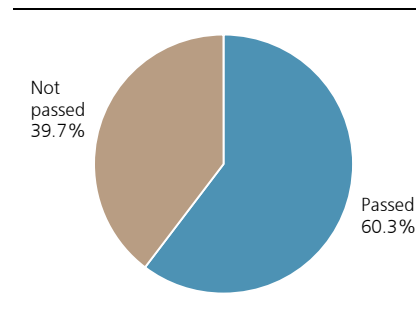
Source: CHFPC, CAPC, CEIC, IMS, Frost&Sullivan, UBS

#### Regulations favour consolidation

In our view, government policy will support increased consolidation across the industry. Taking pharmaceutical manufacturing as an example, the government has issued a series of policies that promote industry consolidation.

- **New Good Manufacturing Practice (GMP) compliance regulation** enhances requirements for all aspects of drug manufacturing. According to the CFDA, 523 sterile manufacturing facilities (40% of total sterile manufacturing facilities) ceased production from 1 January 2014 because of a failure to comply with the new GMP. However, 99 out of the top 100 sterilise pharma manufacturers passed the GMP with the last company in the process of applying for GMP verification before the deadline. Only 19.4% of the non-sterile manufacturing facilities have passed the GMP up to the end of September 2013.
- **Generic product quality re-evaluation.** Although the detailed method of the re-evaluation is still under discussion, we believe companies have to bear additional costs for experiments like in vitro dissolution tests and bioequivalence tests. Those who cannot afford the costs should exit the market.

**Figure 18: ~40% of sterilize pharma manufacturers ceased production due to failure to pass new GMP before deadline**



Source: CFDA

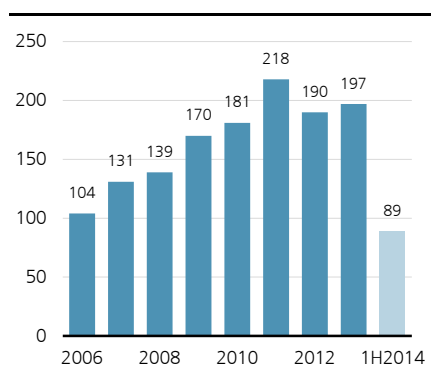


- **Provincial tender policy.** With the intention of promoting consolidation, provincial governments tend to favour large companies in the tender evaluation process. So, leading companies were either grouped in separate classes to avoid price competition with smaller companies in Anhui, or were given the advantage of being awarded higher scores in overall evaluations in Guangdong. As a result, we expect smaller companies to gradually exit the market or end up being acquired.

### Consolidation is accelerating in the China healthcare sector

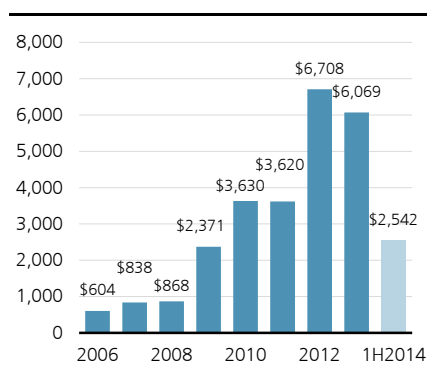
In our view, consolidation is accelerating. In recent years, the number and size of M&A deals has increased. We estimate 50% of M&A deals were in the pharmaceutical manufacturing sector and a further 25% in the medical device sector.

Figure 19: Number of M&A deals



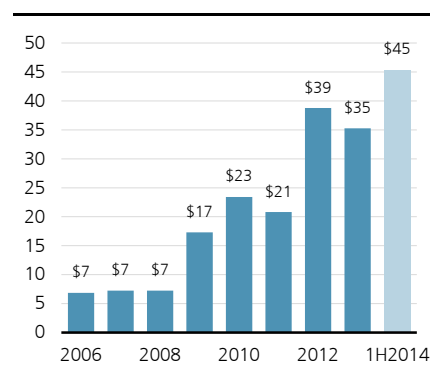
Source: Wind

Figure 20: M&A deal value (US\$ m)



Source: Wind

Figure 21: Average deal size (US\$ m)



Note: Deals disclosed without total consideration information were excluded for deal size calculation.  
Source: Wind

Figure 22: Notable M&As in China healthcare sector (2012-H114)

Buyer	Code	Target		Stake acquired	Consideration US\$ m	Subsector	Year announced
Bayer	BAY.US	Tianhong Pharma	Acquisition	unknown	586	Finished dose manufacturer, including OTC drugs, prescription drugs and nutrition products	2014
Fosun pharma	600196.SS / 2196.HK	Chindex	Privatization	unknown	269	Healthcare service	2014
PKU healthcare	000788.SS	ET Medical	Acquisition	100%	228	Medical device	2014
Stryker	SYK.US	Trauson	Acquisition	100%	780	Orthopaedics	2013
Shanghai RAAS	002252.SS	Banghe Pharma & Banghe Biologics	Acquisition	100%	614	Biopharmaceuticals	2013
Microport	2005.HK	Wright Medical orthopaedic business	Acquisition	unknown	290	Orthopaedics	2013
Hepalink	002399.SS	SPL	Acquisition	100%	223	SPL is US based heparin API manufacturer	2013
CSPC	1093.HK	Enbipu	Acquisition	100%	1154	Chemical drug	2012
Guangzhou Pharma	n.a.	Baiyunshan Pharma	Merger	100%	854	TCM	2012
Medtronic	MDT.US	Kanghui	Acquisition	100%	816	Orthopaedics	2012
Sinopharm group	600056.SS	Tianfang Pharma	Merger	unknown	435	Chemical drug	2012

Source: Wind

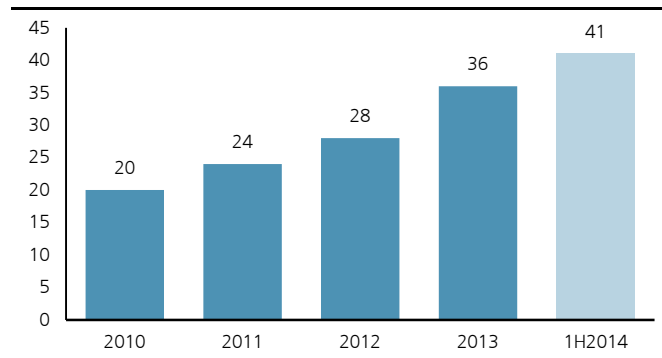
## 4. Innovation

The China pharmaceutical market has been dominated by non-exclusive drugs, with generics taking an 85% share of the total market. The majority of generics

have their own brands (branded generics). In many cases, branded generics have become the most profitable products in the market as they are in: 1) a mature market with limited marketing investment and risks; 2) need limited R&D investment; and 3) attract a premium price.

After 10 years of fast growth based on "me-too" branded generic drugs, China's pharmaceutical manufacturers have started to increase differentiation through original products, either through innovative formulation or different drug delivery systems, which are called "me-better" drugs.

**Figure 23: Number of category 1.1 chemical drugs applied for clinical trials**



Source: CFDA

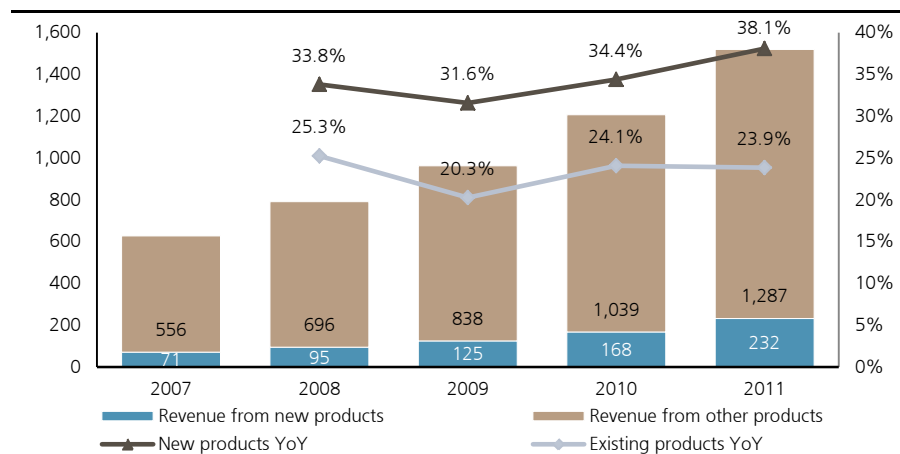
**Figure 24: Number of Class 1.1 drug INDs applied by key major pharma companies since 2010**

Company name	Code	Number of drugs applied for clinical trials
Hengrui Pharma	600276.SS	23
Sihuan Pharma	460.HK	7
Zhejiang Hisun	600267.SS	4
Sino Biopharm	1177.HK	3
CSPC	1093.HK	2

Source: CFDA

The trend in the past few years towards greater innovation can be seen in the growth of new drug sales, which has been much faster than the average for the pharmaceutical manufacturing sector. We expect this trend to continue and to be supported by the strong drug pipelines of the major companies and rising R&D expenditure.

**Figure 25: New drug sales vs. other drug sales (Rmb bn)**



Source: CEIC. Note: API sales are excluded.

**Figure 26: Leading drug makers with heavy R&D investment (2010-13)**

	Code	2010	2011	2012	2013
Hengrui Pharma	600276.SS	n.a.	~9%	~10%	9.08%
Sino Biopharm	1177.HK	5.60%	6.40%	7.20%	8.90%
Zhejiang Hisun	600267.SS	n.a.	4.61%	5.97%	5.58%
CSPC	1093.HK	3.30%	2.60%	2.90%	2.90%

Source: Company data

## Our preferred sub-sectors

In all, there are seven sub-sectors in the Chinese healthcare industry: active pharmaceutical ingredient (API); chemical drugs; traditional Chinese medicine (TCM) drugs; bio pharmacy; pharmaceutical distribution; medical devices; and the healthcare service industry.

The healthcare industry in China is quite diversified: among the almost 200 A-share listed healthcare companies, many operate in niche markets and are quite different from each other. Therefore we believe MMA will allow foreign investors the opportunity to invest in the best companies in diverse niche markets. We prefer:

- 1) Sub-sectors containing listed companies which have (until MMA) been largely inaccessible to overseas investors;
- 2) Sub-sectors with attractive fundamentals and strong growth potential.

Our preferred sub-sectors (and associated stocks) are: TCM (Kanion (600557.SS and Yibai Pharma (600594.SS)), healthcare services (KANG.US and Fosun Pharma (600196.SS/2196.HK)), medical devices (Shinva Medical (600587.SS)) and biological drug makers (Tonghua Dongbao (600867.SS)).

### Traditional Chinese medicine

TCM has been used in China to diagnose, treat and prevent diseases for over 2,000 years. TCM practices include herbal medicine, acupuncture and massage. TCM is based on the "Ying-Yang" and "Jing-Luo" theories which are fundamentally different from Western medicine. The TCM sub-sector of the A-share market contains pharmaceutical companies that develop, manufacture and sell TCM drugs. There are 17 TCM companies on the A-share MMA list, including several leading companies.

According to the CEIC, TCM is the second-biggest sub-segment within the pharmaceutical manufacturing sector with a market size of Rmb506bn; 1,506 TCM companies, including 60 listed companies, compete in the segment. Revenue for the TCM segment is expected to grow at around 23% pa, faster than the pharma sector, according to the CFDA.

We believe growth of TCM companies is strongly supported by factors including:

- The incidence of chronic disease increases dramatically, driven by aging. TCM companies should be strong beneficiaries since TCM has certain advantages in the treatment of chronic disease such as cardiovascular diseases.
- TCM benefits from the Essential Drug List (EDL) policy. Over 50% of TCM drugs on the EDL are proprietary drugs.

We believe the TCM segment is attractive based on the following.

#### (1) **The R&D process of TCM companies is unique and efficient**

There are hundreds of herbal formulas created by experienced practitioners. We believe the safety and effectiveness of the formulas have been proved during two

thousand years of clinical experience. TCM companies can develop drugs based on mature herbal formulas instead of screening unknown chemicals.

## (2) TCM drugs have longer exclusive time

Chemical drugs usually contain only one to two active ingredients which are protected by patents. Brand-name companies enjoy marketing exclusivity as long as patent protection lasts, which is typically about 10 years. In most cases, sales of brand name drugs drop sharply when the compound patent expires due to competition from generic drugs.

But TCM drugs hold exclusivity for a longer time because they are usually multi-ingredient formulas (some of them contain more than 10 active ingredients). And medical material processing is very important for TCM production. The SFDA requires generic drug manufacturers to prove that their material processing is identical to brand name products. In the past three years, only 10 generic TCM drugs were approved by the SFDA while 954 generic chemical drugs were approved in the same period. Therefore, marketed TCM drugs have a much longer life-cycle.

## (3) Market acceptance of TCM is expanding

It has long been a challenge for TCM companies to persuade Western doctors about the effectiveness of TCM drugs as: 1) the fundamental theory of the traditional Chinese medical system (TCM system) is complicated and fundamentally different from Western medicine; 2) some active ingredients of herbal formulas are still unknown; and 3) more studies and statistical data are needed to support the effectiveness and safety of TCM. In order to gain wider market acceptance and especially the support of Western doctors, leading TCM companies typically conduct large-scale clinical trials.

### a. Ph. IV clinical trials to support TCM effectiveness and safety profiles.

Leading TCM pharmaceutical companies such as Kanion Pharma (600557.SS), Yiling Pharma (002603.SS) and Tasley (600535.SS) resorted to large-scale evidence-based Phase IV clinical trials in top grade-III hospitals (the highest hospital level in china) and collected clinical data to support their key products' efficacy and safety profiles. Positive results of Phase IV clinical trials usually drive up sales of relevant TCM drugs significantly.

### b. Seeking mainstream international drug market access is another alternative in getting support for their products' effectiveness and safety.

Tasley's Compound Danshen Dropping Pill passed Phase II clinical trials in the US market and is in the process of patient recruitment for its Phase III clinical trials. We expect robust growth of the Compound Danshen Dropping Pill after the US Food and Drug Administration's (FDA) approval, driven by sales in international markets and more prescriptions from local Western medicine doctors.

**Figure 27: Generic drugs approved by SFDA**

Year	Chemical drug	TCM
2011	431	5
2012	336	2
2013	187	3

Source: CDE

**Figure 28: TCM products processing Phase IV clinical trials**

Key products	Market size, Rmb bn	Company
Compound Danshen Dropping Pill	2.3	Tasley Pharmaceuticals
Yiqi Fumai TCM Injection	0.3	
Danshen Duofensuan TCM Injection		
Tongxinluo Capsule	0.9-1	Yiling Pharmaceutical
Qili Qiangxin Capsule	0.2	
Shensong Yangxin Capsule	0.8	
Reduning injection	1.0	Kanion pharmaceutical
Ginkgo Diterpene injection		

Source: UBS

Driven by aging, EDL policy and expanding market acceptance, the TCM sub-sector has a higher growth rate than the whole pharmaceutical manufacturing sector.

### Preferred TCM stocks in the MMA list

**Kanion.** Kanion is a leading TCM producer with strong R&D capabilities. We are positive on Kanion's long-term growth potential, driven by its major products Reduning and Ginkgolide.

**Yibai Pharmaceutical.** Yibai pharmaceutical has an impressive track record in choosing, evaluating and acquiring products. We expect Yibai to grow rapidly in the next five years.

### Bio pharmacy

Bio pharmacy includes monoclonal antibody drugs, recombinant drugs and blood products. The combined revenue of the biologics segment in China reached Rmb238.1bn in 2013, accounting for 13.3% of the overall pharmaceutical industry. Bio pharmacy realised a revenue CAGR of 24.5% from 2008 to 2013, vs. 23.5% for the overall pharmaceutical industry for the same period, according to the CEIC.

We believe that bio pharmacy will sustain a high rate of growth over the next five years and will be strongly supported by factors including:

- (1) **An aging population.** Due to this shift in demographics, and with a rising incidence of senile diseases, demand for bio pharmacy drugs is likely to be sustained as bio pharmacy has effective treatment solutions for some of these diseases, such as diabetes.
- (2) **Import replacement.** We expect import replacement to continue in certain fields as China's bio pharmacy market is mainly dominated by imported products. We believe that with the increased development of cheaper domestic substitutes, import replacement will be a strong driver for China's bio pharmacy sector.

Stocks eligible for MMA, including market leaders in the biologic drug sector like Tonghua Dongbao, will provide overseas investors greater access to the China biologic drug sector. We believe this is an attractive sector, given:

- (1) Bio pharmacy, especially monoclonal antibody drugs and recombinant drugs, is a fairly effective treatment for diseases like tumours and auto-immune diseases and its clinical applications have widened.

- (2) Like many MNCs, Chinese bio pharmacy corporations devote a great deal of effort to R&D and, in our opinion, are about to realise the benefits of this investment. The CFDA has already approved a series of generic antibody drugs. Domestic third-generation insulin has also been approved and is now well accepted by the market. We expect more monoclonal antibody drugs and recombinant drugs to be released in the future.

### Preferred bio pharmacy stock in the MMA list

**Tonghua Dongbao.** Dongbao is the domestic market leader in the insulin product field and focuses on the primary care market. We believe that primary insulin market volume will increase rapidly in the next two to three years.

## Healthcare service

According to 2012 data, there are over 10,000 hospitals operating in China with total revenue of about Rmb1,520bn, among which 10% of beds are owned by social capital. We believe that an increasingly aging population and growing affordability (due to improving living standards and increasing insurance coverage) are important driving forces for the development of the healthcare service industry. For social-run hospitals, favourable policies are another driving force for their development.

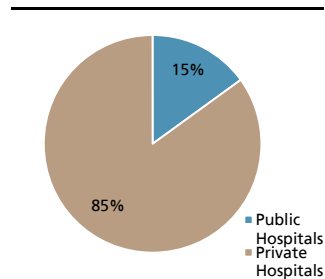
Currently, there are about 30 A-share listed companies engaged in the healthcare service business, but with only three with it as their core business. Nevertheless, many companies are planning to enter the business and we believe that more healthcare service companies will be listed in the future. There are eight MMA eligible companies engaged in the healthcare service business.

We are bullish view on the healthcare service sector for two reasons:

### (1) We believe the healthcare service sector has high potential

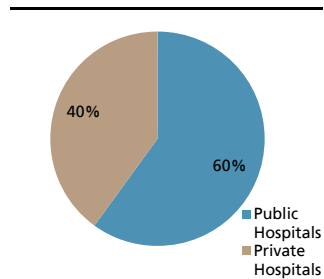
China's hospitals depend largely on the sale of drugs to subsidise deeply under-priced services. According to 2012 data, healthcare sector revenue is split 1:1 in terms of revenue between drugs sales (Rmb1,400bn) and services provided (Rmb1,500bn), while the figure in the US is 1:8. In China only 10% of total beds belong to social-run hospitals while in the US only about 14% of beds are owned by the government.

**Figure 29: US hospital composition**



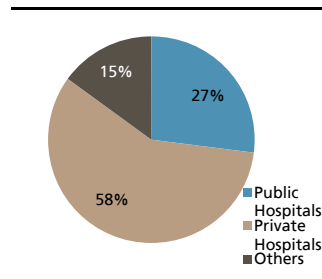
Source: AHA

**Figure 30: China hospital composition**



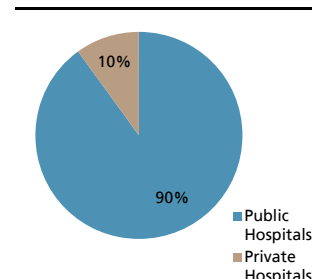
Source: CHFPC

**Figure 31: US patient treatment allocation**



Source: AHA

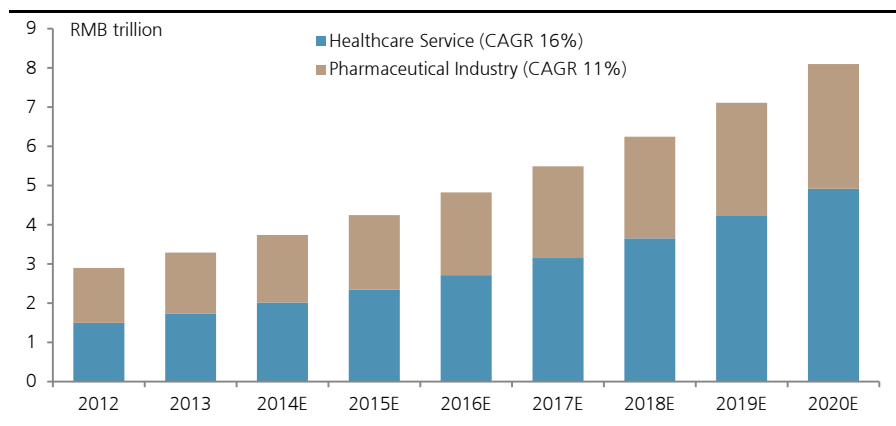
**Figure 32: China patient treatment allocation**



Source: CHFPC

The Chinese government has proposed that by 2020, overall healthcare industry revenue will reach Rmb8trn. If we assume that the healthcare service proportion of hospital revenue rises a conservative 60% by 2020, the industry would achieve a revenue CAGR of 16% by 2020E, faster than the pharmaceutical industry at about 11%.

**Figure 33: Healthcare revenue to record high growth up to 2020E**



Source: UBS-S estimates

## (2) Investment in the healthcare sector is increasing with policy tailwinds

The Chinese government has released a series of policies to encourage private capital to invest in healthcare services. The market is interpreting this as the government's dedication in opening up the healthcare sector and is expecting further positive policies including, but not limited to, preferential tax policies and multi-sited licences for doctors. Along with the improving regulatory environment, private investment in hospitals is increasing, as shown below.

**Figure 34: Policies on opening up of China Healthcare service sector to social capital**

Date	Policy	Key points
2009.4	Opinions regarding deeper movement in Chinese healthcare reform	Encourage non-public capital to run hospitals
2010.5	Opinions regarding encouraging social capital to run hospitals (New 36)	Encourage non-public capital to run hospitals, make policies regarding tax come into effect, make sure social-run hospital be in the same status as public hospitals
2010.11	Opinions regarding further encouraging social capital to run hospitals (No. 58 Document)	More detailed policies about tax and expense (water, electricity, gas, energy, etc.) benefit to social-run hospitals
2011.2	Announcement on pilot work about public hospital reform	Leave space for social-run hospitals, restrict the special service in public hospitals to no more than 10% of its health resources
2012.3	12th Five Year schedule on healthcare system reform	By 2015, 20% of total beds and healthcare service would be run by social capital
2013.10	Opinions regarding promoting development of healthcare service industry by State Council	Make healthcare service industry in the higher place as an important driving force for economy development, set the target that by 2020 the industry would reach 8000 billion RMB
2013.11	CCP decision on major issues of deepening the reform	Accelerate the process of public hospitals reform and encourage social capital to run hospitals, meeting requirements of various demand

Source: Government data

**Figure 35: Acquisitions of hospitals in recent years**

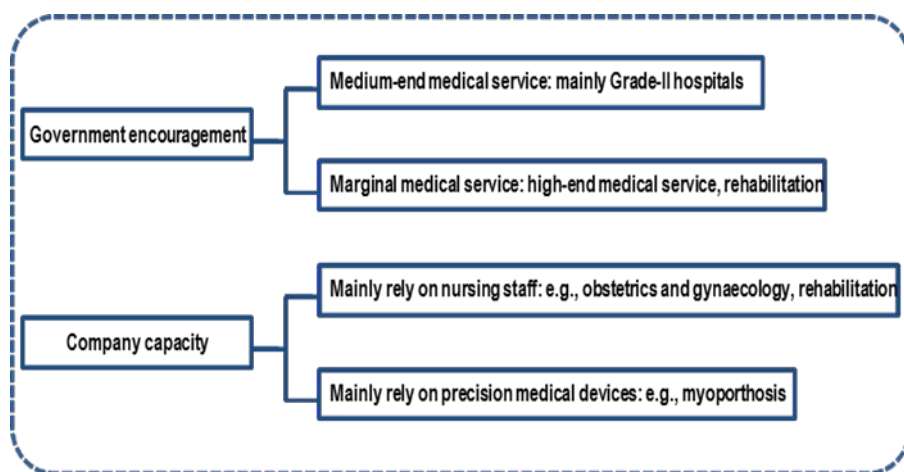
Year of deal announcement	Deal count	Sum of deal value	Average deal size (US\$ m)
2011	4	22.44	\$5.61
2012	3	20.76	\$6.92
2013	9	439.6	\$48.84
1H2014	7	55.59	\$7.94

Source: Wind

The Chinese healthcare system has long been criticised for its inefficiency and heavy financial burden on patients. We believe this inefficiency is due to healthcare resource mismatching and the mispricing of healthcare services.

The opening up of the healthcare service segment to private capital and the creation of multiple markets to target different patients / customer groups is an important part of the overall solution to rectify China's healthcare system. Specifically, we believe that medical services segments, encouraged by the government (Figure 36), are more likely to achieve higher growth in the future.

**Figure 36: Medical Service segments where social capital has advantages**



Source: UBS

### Preferred healthcare service stock in the MMA list

**Fosun Pharma.** Fosun Pharma, dual-listed in the A-share (600196.SS) and H-share (2196.HK) markets, runs six hospitals (2,100 beds). We expect Fosun's healthcare service to grow quickly over the next few years, with total beds reaching 5,000 this year and about 10,000 by 2015.

### Medical devices

The medical devices segment includes manufacturers of instruments, apparatus, implants and in vitro reagents used in hospitals. China's medical device sector recorded revenue of Rmb343bn in 2013, a CAGR of 22.7% from 2008 to 2013.

However, we believe that there is still high potential for China's medical device sector with growth strongly supported by factors including:

- (1) **Demographics.** As previously mentioned, the ongoing aging trend in China should lead to growing demand for self-diagnosis devices like the hemomanometer. We believe there is substantial potential for further market expansion of medical equipment manufacturers and their products, such as oxygen machines and blood glucose meters.
- (2) **Import replacement** should also be a key driver for the long-term growth of the medical device sector. With the rapid development of non-public medical institutions, we believe domestic medical device manufacturers are poised to gain market share as private healthcare institutions are usually more cost-conscious and typically prefer domestic products to foreign ones.
- (3) **Favourable government policies and investments.** China's Ministry of Health issued the "Healthy China 2020 Strategy Research Report" in 2012, which mentioned a total investment of Rmb400bn to be spent over the next eight years in the seven subsectors of China healthcare industry. Of this



investment, up to Rmb109bn was explicitly designated for county-level hospital construction. The investment plan is almost 10x bigger than the one announced in 2008 (Rmb50bn). Medical devices accounted for 42% of the total revenue of healthcare sector in the global market, while it only accounted for 19.2% of China's healthcare products market. There's still much room for growth, in our view.

- (4) **Leveraging cost advantages and continuously improving technologies relative to the global market.** Chinese medical device exports have risen in the past few years. We believe that the global market presents big opportunities for Chinese medical device companies considering they are able to provide: 1) reliable product quality supported by improving technology and; 2) competitive product pricing from a lower cost base.

#### **Preferred medical device stock in the MMA list**

**Shinva Medical.** Shinva Medical has the most comprehensive production line, including medical devices, hospital sterilisation products, in-vitro diagnostic reagents, hospital supplies and other products, in addition to exposure to the pharmaceutical equipment industry and healthcare services industries. Shinva has maintained rapid growth through an "organic + inorganic M&A" business model, and we believe the company is one of the top medical device manufacturers with the best growth potential.

# Appendix

## UBS China healthcare coverage

Figure 37: A-share healthcare companies covered by UBS-S (MMA listed names are shaded)

Company Name	Code	Market Cap (Rmb m)	Daily Volume	Price Target (Rmb)	Rating	2014E PE (x)	2015E PE (x)
Aier Eye Hospital	300015.SZ	17186	2335288	33.00	Buy	53	42
Cachet	002462.SZ	4714	2374513	25.00	Buy	37	28
Dong-E E-jiao	000423.SZ	24735	5979419	55.00	Buy	16	13
Double-Crane Pharma	600062.SS	10628	4159839	32.00	Buy	14	11
Er-kang Pharma	300267.SZ	15693	2309018	43.50	Buy	62	46
Fosun Pharmaceutical	600196.SS	42904	26442970	27.00	Buy	17	15
Hengchang Medical	002219.SZ	13541	5547460	30.00	Buy	44	31
Hengrui Medicine	600276.SS	51331	5238230	40.90	Buy	33	27
Hokai Instruments	300273.SZ	12357	4231572	30.00	Buy	44	32
Huahai Pharma	600521.SS	10005	7916209	14.00	Buy	29	22
Humanwell Healthcare	600079.SS	14446	5331962	36.00	Buy	29	23
Jiangzhong Pharma	600750.SS	5106	3919671	17.50	Neutral	24	19
Jinling Pharma	000919.SZ	6502	7998470	18.50	Buy	34	27
Kanion Pharma	600557.SS	13926	3441247	35.70	Buy	36	27
Kehua Bioengineering	002022.SZ	12332	6560897	32.00	Buy	36	26
Nhwa Pharmaceutical	002262.SZ	9301	1179598	25.50	Neutral	39	30
Realcan Pharma	002589.SZ	6970	189018	34.85	Buy	39	30
Salubris Pharma	002294.SZ	19489	3552235	52.00	Buy	18	14
Shanghai Pharma-A	601607.SS	34579	16140563	18.00	Buy	14	12
Shinva Medical	600587.SS	13465	1335539	52.50	Buy	40	27
Sinopharma Accord	000028.SZ	17522	1398007	58.00	Buy	27	21
Tianyao Pharmaceutic	600488.SS	4814	5241988	5.20	Buy	47	37
Tofflon	300171.SZ	7144	2292301	32.30	Buy	22	18
Tonghua Dongbao	600867.SS	13803	8309648	16.36	Buy	36	26
Topchoice Medical	600763.SS	7405	1627651	55.00	Buy	62	44
Xinbang Pharma	002390.SZ	10990	2195756	21.96	Neutral	67	51
Yibai Pharma	600594.SS	16026	2031967	49.00	Buy	27	21
Yiling Pharma	002603.SZ	17185	2401117	40.00	Buy	41	31
Yuyue Medical	002223.SZ	15284	3586311	35.00	Buy	47	37
Zhejiang NHU	002001.SZ	16040	6754837	18.70	Buy	12	9
Zhongsheng Pharma	002317.SZ	7795	2419974	30.00	Buy	28	19

Note: Prices as of 15 August 2014. Source: Wind, UBS-S estimates (companies with grey shading are in the MMA list)

Figure 38: A-share top picks in healthcare industry

Company Name	Code	Market Cap (Rmb m)	Daily Volume	Price Target (Rmb)	Rating	2014E PE (x)	2015E PE (x)
Aier Eye Hospital	300015.SZ	17186	2335288	33.00	Buy	53	42
Hengrui Medicine	600276.SS	51331	5238230	40.90	Buy	33	27
Kehua Bioengineering	002022.SZ	12332	6560897	32.00	Buy	36	26
Tonghua Dongbao	600867.SS	13803	8309648	16.36	Buy	36	26
Topchoice Medical	600763.SS	7405	1627651	55.00	Buy	62	44

Note: Prices as of 15 August 2014. Source: Wind, UBS-S estimates

**Figure 39: UBS covered overseas listed healthcare companies (UBS top picks are shaded)**

Company name	Code	Market cap (in US\$ m)	Daily volume (US\$ m)	Price target	Rating	PT implied PE		Trading PE (x)	
						2014E	2015E	2014E	2015E
Fosun	2196.HK	6,858	8	HKD 29.08	Neutral	21.5	18.0	18.9	15.8
Sihuan Pharma	0460.HK	6,686	11	HKD 5.55	Buy	27.5	21.6	24.7	19.5
Shanghai Pharma	2607.HK	5,565	5	HKD 18.50	Buy	15.9	13.7	13.4	11.5
CSPC	1093.HK	4,606	11	HKD 8.49	Buy	35.2	27.3	26.5	20.5
SinoBiopharm	1177.HK	4,501	6	HKD 7.05	Neutral	28.0	23.3	28.0	23.3
Weigao	1066.HK	4,465	5	HKD 9.10	Neutral	29.8	24.4	25.3	20.7
CMS	0867.HK	3,081	3	HKD 11.30	Buy	27.7	22.4	24.3	19.6
Luye Pharma	2186.HK	3,034	4	HKD 8.40	Buy	37.0	27.2	31.2	22.9
iKang	Kang.US	1,342	2	HKD 20.37	Buy	38.0	27.6	37.8	27.4
FSY	1448.HK	1,149	2	HKD 6.22	Buy	43.7	34.2	30.2	23.6
Pioneer	1345.HK	943	3	HKD 5.79	Buy	18.9	14.8	17.9	14.0

Source: Bloomberg, UBSS estimates, trading PE calculated based on market close prices of 15 August

# Jiangsu Kanion Pharmaceutical

## Leading modern TCM producer with strong R&D capabilities

### Leading modern TCM producer with strong R&D capabilities

Kanion Pharma is a modern traditional Chinese medicine (TCM) producer with strong R&D capabilities. Its product line includes two proprietary TCM injection products (anti-inflammatory and cardiovascular drugs) and five proprietary essential drugs (gynaecological and orthopaedic). Reduning, a TCM injection which was approved by regulators in 2005 and is used for 'heat-clearing' and detoxification, contributes nearly 50% of the company's revenue and has been the main earnings growth driver in recent years. Ginkgolide injection (approved at end-2012) is a new cardiovascular drug. We expect the potential sales of the two major TCM injections combined at Rmb3bn in the next three to five years.

### Focus on end-market sales: expected benefits from a new marketing strategy

The company increased marketing capabilities with a new marketing strategy in late 2011 focusing on end-market sales. We believe that on the one hand, the weighting of TCM injections, which have less reliance on distribution, has increased; on the other hand, it can take advantage of its proprietary medical insurance drugs to drive long-term stable earnings growth after streamlining marketing.

### Private placement highlights controlling shareholder and mgmt confidence

On 9 August, Kanion said it plans to issue 4,977,242 shares (0.97% stake) to the controlling shareholder and 9,954,330 shares (1.94% stake) to senior managers through a private placement at Rmb24.11/share with a 36-month lock-up period. The controlling shareholder and 24 senior executives bought 2,240,305 shares in Kanion (0.54% stake) in June via an asset management plan with a 24-month lock-up period. We believe the share purchase and private placement within two months reflect the controlling shareholder and management's confidence in Kanion's development over the next three years.

### Valuation: Buy rating and Rmb35.70 price target

We estimate 2014-16E EPS at Rmb0.76/1.02/1.15. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool (assuming a 7.5% WACC). We are positive on Kanion's long-term growth potential, driven by its major products Reduning and Ginkgolide.

### Equities

China  
Pharmaceuticals

**12-month rating** **Buy**

**12m price target** **Rmb35.70**

**Price** **Rmb27.92**

**RIC:** 600557.SS **BBG:** 600557 CH

### Trading data and key metrics

**52-wk range** Rmb31.81-21.34

**Market cap.** Rmb13.9bn/US\$2.27bn

**Shares o/s** 499m (ORDA)

**Free float** 62%

**Avg. daily volume ('000)** 3,653

**Avg. daily value (m)** Rmb99.3

**Common s/h equity (12/14E)** Rmb2.21bn

**P/BV (12/14E)** 6.3x

**Net debt / EBITDA (12/14E)** 0.6x

### EPS (UBS, diluted) (Rmb)

	UBS	Cons.
<b>12/14E</b>	0.76	0.75
<b>12/15E</b>	1.02	0.95
<b>12/16E</b>	1.15	1.16

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Analyst

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Highlights (Rmbm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	1,538	1,903	2,230	2,851	3,638	4,547	5,410	6,330
EBIT (UBS)	227	301	364	480	631	725	866	1,013
Net earnings (UBS)	154	212	262	379	508	572	694	828
EPS (UBS, diluted) (Rmb)	0.31	0.43	0.52	0.76	1.02	1.15	1.39	1.66
DPS (Rmb)	0.05	0.05	0.06	0.10	0.23	0.31	0.35	0.42
Net (debt) / cash	(412)	(481)	(530)	(409)	(314)	(238)	(56)	256
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	14.7	15.8	16.3	16.8	17.4	15.9	16.0	16.0
ROIC (EBIT) %	13.6	15.3	16.4	19.1	22.7	23.3	24.9	26.5
EV/EBITDA (core) x	25.9	20.0	28.3	22.4	17.7	15.6	13.2	11.3
P/E (UBS, diluted) x	42.6	30.8	44.3	36.7	27.4	24.3	20.1	16.8
Equity FCF (UBS) yield %	3.9	6.4	2.7	1.4	1.6	1.9	2.7	3.8
Net dividend yield %	0.4	0.4	0.3	0.4	0.8	1.1	1.2	1.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rmb27.92 on 15 Aug 2014 22:37 HKT

# Investment Thesis

## Kanion Pharma

### Investment case

Jiangsu Kanion Pharmaceutical (Kanion Pharma) is a traditional Chinese medicine producer with strong R&D capabilities. Its product line includes two proprietary Traditional Chinese Medicine (TCM) injection products (anti-inflammatory and cardiovascular drugs) and five proprietary essential drugs (gynaecological and orthopaedic). The company has focused on raising sales. We estimate a net profit CAGR of 30% over the next three years from: 1) greater benefits from the gradual implementation of the essential drug policy; 2) an increase in new product sales (Ginkgolide injections) after the start of provincial tendering; and 3) steady increases in the use of TCM anti-inflammatory injections following the restrictions on antibiotics drugs. We rate the company a Buy because we believe it is undervalued based on its strong product line and growth prospects.

### Upside scenario

Our upside case assumes that sales of Reduning grow rapidly, Ginkgolide injections are included in tendering, overall sales accelerate in H2 and essential drug sales are better than expected. If this materialises, the company's revenue growth may reach 35%. In this scenario, our 2014E EPS is Rmb0.81 with our upside valuation at Rmb38.00.

### Downside scenario

Our downside case assumes Ginkgolide injections' performance undershoots, while Reduning sales slowdown and essential drug sales are worse than expected. In this scenario, revenue growth may decline to 20% and 2014E EPS to Rmb0.70. Our downside valuation would be Rmb30.60.

### Upcoming catalysts

The company's private placement proposal is approved in Q3 after modification;  
Ginkgolide injections are included in the health insurance schemes of more provinces in H2;  
Reduning is included in the supplemental provincial essential drug list in H2.

12-month rating

**Buy**

12m price target

**Rmb35.70**

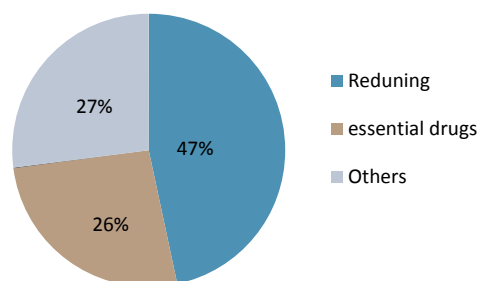
### Business description

Jiangsu Kanion Pharmaceutical (Kanion Pharma) is a traditional Chinese medicine producer with R&D capabilities. The company initially developed herbal medicine pills for use in gynecological and orthopaedic treatments and introduced products such as a 'Guizhi Fuling' capsule and a lumbar paralysis capsule. In 2005, the company launched a 'Reduning injection' (a traditional Chinese medicine used for 'heat-clearing' and detoxification) product, which has now become a key growth driver. Kanion Pharma has diversified products in the pipeline in a number of important therapeutic areas.

### Industry outlook

We believe China's pharma industry will maintain 15% growth over the next 5-10 years due to inelastic demand from population ageing and urbanisation. We foresee differentiated drug performance in the future: 1) essential drug growth will outpace the pharma sector average, with proprietary essential drugs increasing at an even faster pace as their prices are likely to remain stable; 2) following the restrictions on antibiotic usage, TCM anti-inflammatory injection sales have grown rapidly. We believe this rapid growth will be sustainable; and 3) cardiovascular injections may rise from an increase in heart disease patients, and have significant potential.

### Revenues by segment (2013)



Source: Company data

### Gross profit by segment

Rmb m	2012	2013	2014E	2015E	2016E
Reduning	688	830	1082	1352	1622
Essential drugs	315	392	490	627	791
Ginkgolide	0	2	46	135	270
Others	428	435	509	601	688
<b>Total</b>	<b>1431</b>	<b>1665</b>	<b>2127</b>	<b>2716</b>	<b>3371</b>

Source: Company data, UBS-S estimates

## Jiangsu Kanion Pharmaceutical (600557.SS)

Income statement (Rmbm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
<b>Revenues</b>	<b>1,538</b>	<b>1,903</b>	<b>2,230</b>	<b>2,851</b>	<b>27.8</b>	<b>3,638</b>	<b>27.6</b>	<b>4,547</b>	<b>5,410</b>	<b>6,330</b>
Gross profit	1,112	1,431	1,665	2,127	27.7	2,716	27.7	3,371	4,004	4,684
<b>EBITDA (UBS)</b>	<b>273</b>	<b>349</b>	<b>428</b>	<b>641</b>	<b>49.8</b>	<b>807</b>	<b>25.9</b>	<b>912</b>	<b>1,062</b>	<b>1,218</b>
Depreciation & amortisation	(46)	(48)	(63)	(161)	153.3	(175)	8.9	(187)	(197)	(205)
<b>EBIT (UBS)</b>	<b>227</b>	<b>301</b>	<b>364</b>	<b>480</b>	<b>31.8</b>	<b>631</b>	<b>31.5</b>	<b>725</b>	<b>866</b>	<b>1,013</b>
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	(7)	(3)	(2)	(8)	-249.3	(8)	-0.5	(9)	(10)	(10)
Net interest	(38)	(56)	(56)	(41)	26.5	(37)	9.7	(35)	(31)	(19)
Exceptionals (incl goodwill)	31	32	40	0	-	0	-	0	0	0
<b>Profit before tax</b>	<b>213</b>	<b>274</b>	<b>346</b>	<b>431</b>	<b>24.6</b>	<b>586</b>	<b>36.0</b>	<b>680</b>	<b>825</b>	<b>984</b>
Tax	(24)	(34)	(46)	(48)	-5.2	(73)	-51.8	(102)	(124)	(148)
<b>Profit after tax</b>	<b>189</b>	<b>240</b>	<b>300</b>	<b>383</b>	<b>27.6</b>	<b>513</b>	<b>34.0</b>	<b>578</b>	<b>701</b>	<b>837</b>
Preference dividends and Minorities	(7)	0	(4)	(4)	-4.4	(5)	-34.0	(6)	(7)	(8)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
<b>Net earnings (local GAAP)</b>	<b>182</b>	<b>240</b>	<b>296</b>	<b>379</b>	<b>27.9</b>	<b>508</b>	<b>34.0</b>	<b>572</b>	<b>694</b>	<b>828</b>
<b>Net earnings (UBS)</b>	<b>154</b>	<b>212</b>	<b>262</b>	<b>379</b>	<b>44.8</b>	<b>508</b>	<b>34.0</b>	<b>572</b>	<b>694</b>	<b>828</b>
Tax rate (%)	11.4	12.5	13.3	11.2	-15.6	12.5	11.6	15.0	15.0	15.0
<b>Per share (Rmb)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
EPS (UBS, diluted)	0.31	0.43	0.52	0.76	44.8	1.02	34.0	1.15	1.39	1.66
EPS (local GAAP, diluted)	0.36	0.48	0.59	0.76	27.9	1.02	34.0	1.15	1.39	1.66
EPS (UBS, basic)	0.31	0.43	0.52	0.76	44.8	1.02	34.0	1.15	1.39	1.66
Net DPS (Rmb)	0.05	0.05	0.06	0.10	71.4	0.23	127.9	0.31	0.35	0.42
Book value per share	2.83	3.23	3.77	4.43	17.6	5.22	17.8	6.06	7.10	8.34
Average shares (diluted)	498.78	498.78	498.78	498.78	0.0	498.78	0.0	498.78	498.78	498.78
<b>Balance sheet (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Cash and equivalents	203	344	292	371	27.1	473	27.5	591	703	822
Other current assets	1,392	1,489	1,456	1,848	26.9	2,351	27.2	2,919	3,472	4,067
<b>Total current assets</b>	<b>1,595</b>	<b>1,833</b>	<b>1,748</b>	<b>2,219</b>	<b>26.9</b>	<b>2,824</b>	<b>27.3</b>	<b>3,510</b>	<b>4,175</b>	<b>4,889</b>
Net tangible fixed assets	561	729	1,102	1,161	5.4	1,175	1.2	1,163	1,133	1,090
Net intangible fixed assets	181	223	283	269	-4.8	256	-5.1	242	228	215
Investments / other assets	245	340	300	226	-24.6	182	-19.5	154	134	117
<b>Total assets</b>	<b>2,581</b>	<b>3,125</b>	<b>3,432</b>	<b>3,876</b>	<b>12.9</b>	<b>4,437</b>	<b>14.5</b>	<b>5,069</b>	<b>5,670</b>	<b>6,310</b>
Trade payables & other ST liabilities	489	641	655	807	23.2	961	19.1	1,127	1,270	1,476
Short term debt	466	630	655	576	-12.01	565	-2.01	598	514	311
<b>Total current liabilities</b>	<b>955</b>	<b>1,271</b>	<b>1,310</b>	<b>1,383</b>	<b>5.6</b>	<b>1,526</b>	<b>10.3</b>	<b>1,725</b>	<b>1,784</b>	<b>1,787</b>
Long term debt	148	195	167	203	21.8	222	9.1	231	244	256
Other long term liabilities	3	8	21	21	0.0	21	2.9	21	22	22
Preferred shares	0	0	0	0	-	0	-	0	0	0
<b>Total liabilities (incl pref shares)</b>	<b>1,107</b>	<b>1,474</b>	<b>1,498</b>	<b>1,607</b>	<b>7.3</b>	<b>1,769</b>	<b>10.1</b>	<b>1,977</b>	<b>2,050</b>	<b>2,064</b>
Common s/h equity	1,436	1,611	1,879	2,209	17.6	2,603	17.8	3,022	3,543	4,160
Minority interests	39	39	56	59	6.9	65	8.6	70	77	86
<b>Total liabilities &amp; equity</b>	<b>2,581</b>	<b>3,125</b>	<b>3,432</b>	<b>3,876</b>	<b>12.9</b>	<b>4,437</b>	<b>14.5</b>	<b>5,069</b>	<b>5,670</b>	<b>6,310</b>
<b>Cash flow (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net income (before pref divs)	182	240	296	379	27.9	508	34.0	572	694	828
Depreciation & amortisation	46	48	63	161	153.3	175	8.9	187	197	205
Net change in working capital	(307)	(28)	88	(261)	-	(373)	-43.4	(407)	(428)	(405)
Other operating	397	240	(59)	51	-	50	-3.3	49	46	37
<b>Operating cash flow</b>	<b>318</b>	<b>499</b>	<b>388</b>	<b>331</b>	<b>-14.8</b>	<b>359</b>	<b>8.7</b>	<b>401</b>	<b>509</b>	<b>665</b>
Tangible capital expenditure	(56)	(82)	(77)	(130)	-69.6	(130)	0.0	(130)	(130)	(130)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	0	0	0	-	0	-	0	0	0
Other investing	0	0	0	(1)	-	0	-	0	(1)	0
<b>Investing cash flow</b>	<b>(56)</b>	<b>(82)</b>	<b>(77)</b>	<b>(132)</b>	<b>-71.3</b>	<b>(131)</b>	<b>0.9</b>	<b>(131)</b>	<b>(131)</b>	<b>(131)</b>
Equity dividends paid	(25)	(25)	(29)	(50)	-71.4	(114)	-127.9	(154)	(173)	(210)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	25	25	29	(28)	-	(20)	28.83	(40)	(22)	(12)
Change in debt & pref shares	0	0	0	(42)	-	7	-	42	(70)	(192)
<b>Financing cash flow</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>(120)</b>	<b>-</b>	<b>(127)</b>	<b>-5.5</b>	<b>(152)</b>	<b>(266)</b>	<b>(414)</b>
<b>Cash flow inc/(dec) in cash</b>	<b>262</b>	<b>417</b>	<b>311</b>	<b>79</b>	<b>-74.6</b>	<b>102</b>	<b>29.5</b>	<b>118</b>	<b>112</b>	<b>120</b>
FX / non cash items	(211)	(276)	(364)	0	-	0	-	0	0	0
<b>Balance sheet inc/(dec) in cash</b>	<b>51</b>	<b>141</b>	<b>(53)</b>	<b>79</b>	<b>-</b>	<b>102</b>	<b>29.1</b>	<b>118</b>	<b>112</b>	<b>119</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## Jiangsu Kanion Pharmaceutical (600557.SS)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	36.2	27.2	39.1	36.7	27.4	24.3	20.1	16.8
P/E (UBS, diluted)	42.6	30.8	44.3	36.7	27.4	24.3	20.1	16.8
P/CEPS	32.7	25.1	35.7	25.8	20.4	18.3	15.6	13.5
Equity FCF (UBS) yield %	3.9	6.4	2.7	1.4	1.6	1.9	2.7	3.8
Net dividend yield (%)	0.4	0.4	0.3	0.4	0.8	1.1	1.2	1.5
P/BV x	4.7	4.1	6.2	6.3	5.3	4.6	3.9	3.3
EV/revenues (core)	4.6	3.7	5.4	5.0	3.9	3.1	2.6	2.2
EV/EBITDA (core)	25.9	20.0	28.3	22.4	17.7	15.6	13.2	11.3
EV/EBIT (core)	NM	23.2	NM	29.9	22.6	19.6	16.2	13.6
EV/OpFCF (core)	NM	21.4	28.2	25.5	20.2	17.7	14.8	12.4
EV/op. invested capital	4.2	3.6	5.4	5.7	5.1	4.6	4.0	3.6
<b>Enterprise value (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Market cap.	6,641	6,549	11,597	13,926	13,926	13,926	13,926	13,926
Net debt (cash)	412	481	530	409	314	238	56	(256)
Buy out of minorities	39	39	56	59	65	70	77	86
Pension provisions/other	0	0	0	0	0	0	0	0
<b>Total enterprise value</b>	<b>7,092</b>	<b>7,070</b>	<b>12,183</b>	<b>14,394</b>	<b>14,304</b>	<b>14,234</b>	<b>14,059</b>	<b>13,756</b>
Non core assets	(4)	(85)	(64)	(58)	(47)	(35)	(22)	(9)
<b>Core enterprise value</b>	<b>7,088</b>	<b>6,985</b>	<b>12,119</b>	<b>14,336</b>	<b>14,257</b>	<b>14,199</b>	<b>14,037</b>	<b>13,747</b>
<b>Growth (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Revenue	13.2	23.8	17.2	27.8	27.6	25.0	19.0	17.0
EBITDA (UBS)	14.0	27.7	22.6	49.8	25.9	13.1	16.5	14.6
EBIT (UBS)	11.4	32.9	20.9	31.8	31.5	14.8	19.4	17.0
EPS (UBS, diluted)	-3.4	37.2	23.5	44.8	34.0	12.7	21.3	19.3
Net DPS	-42.2	1.8	14.6	71.4	127.9	35.4	12.7	21.3
<b>Margins &amp; Profitability (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Gross profit margin	72.3	NM	74.7	74.6	74.7	74.1	74.0	74.0
EBITDA margin	17.8	18.3	19.2	22.5	22.2	20.1	19.6	19.2
EBIT margin	14.7	15.8	16.3	16.8	17.4	15.9	16.0	16.0
Net earnings (UBS) margin	10.0	11.1	11.7	13.3	14.0	12.6	12.8	13.1
ROIC (EBIT)	13.6	15.3	16.4	19.1	22.7	23.3	24.9	26.5
ROIC post tax	12.0	13.4	14.2	17.0	19.9	19.8	21.2	22.6
ROE (UBS)	11.7	13.9	15.0	18.5	21.1	20.4	21.2	21.5
<b>Capital structure &amp; Coverage (x)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net debt / EBITDA	1.5	1.4	1.2	0.6	0.4	0.3	0.1	(0.2)
Net debt / total equity %	27.9	29.1	27.4	18.0	11.8	7.7	1.5	(6.0)
Net debt / (net debt + total equity) %	21.8	22.6	21.5	15.3	10.5	7.1	1.5	(6.4)
Net debt/EV	5.8	6.9	4.4	2.9	2.2	1.7	0.4	(1.9)
Capex / depreciation %	131.1	188.1	135.7	97.5	88.0	81.6	76.9	73.2
Capex / revenue %	3.7	4.3	3.4	4.6	3.6	2.9	2.4	2.1
EBIT / net interest	6.0	5.4	6.5	11.7	17.0	20.5	28.0	53.5
Dividend cover (UBS)	6.2	8.3	9.0	7.6	4.5	3.7	4.0	3.9
Div. payout ratio (UBS) %	16.1	12.0	11.1	13.2	22.4	26.9	25.0	25.4
<b>Revenues by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	1,538	1,903	2,230	2,851	3,638	4,547	5,410	6,330
<b>Total</b>	<b>1,538</b>	<b>1,903</b>	<b>2,230</b>	<b>2,851</b>	<b>3,638</b>	<b>4,547</b>	<b>5,410</b>	<b>6,330</b>
<b>EBIT (UBS) by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	227	301	364	480	631	725	866	1,013
<b>Total</b>	<b>227</b>	<b>301</b>	<b>364</b>	<b>480</b>	<b>631</b>	<b>725</b>	<b>866</b>	<b>1,013</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

# Guizhou Yibai Pharmaceutical

## Extensive product pipeline, advantages gradually emerging

### TCM maker with ability to acquire drugs with a strong product pipeline

Yibai's products include prescription and over-the-counter drugs, covering anti-tumour, cardiovascular and reproductive medicines, with a leading position in the first two segments. It has one of the strongest sales teams in China. More importantly, it has a complete suite of products and ample products in the pipeline, which we believe gives it an advantage at a time when new drugs are scarce.

### Impressive ability to choose products and strong M&A capability

We think Yibai is not particularly good at R&D, but it seems to have an impressive ability to choose, evaluate and acquire products. It has obtained a number of valuable drugs via M&A in recent years, including Lobaplatin, Reteplase and Baogong Zhixue Keli (a haemostatic drug), which have effectively enriched Yibai's product mix. We expect Yibai's value to emerge gradually, given the current industry environment of stringent product approval and scarcity of drugs.

### Expected to grow rapidly in the next five years; re-rating likely to continue

We think that sales of Yibai's drugs with the largest potential will grow rapidly, while sales of existing important drugs should grow steadily. We also believe Yibai will be able to exploit the potential of TCM. We expect sales of existing important drugs such as Aidi to grow steadily, drugs with the best potential, such as Reteplase and Lobaplatin to maintain their high growth and become key drivers of performance in the next five years, and some unique tier-three drugs, such as Xinmaitong capsules, to generate around Rmb300 in revenue. We expect sales growth to be underpinned by the company's products in all three tiers. We look for Yibai's earnings to continue to beat market expectations and drive up the company's valuation.

### Valuation: price target of Rmb49.00; Buy rating

Our 2014/2015/2016 EPS estimates are Rmb1.45/Rmb1.85/Rmb2.44. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool (assuming a WACC of 7.7%). Yibai is one of our preferred TCM makers among the MMA eligible stocks.

### Equities

China  
Pharmaceuticals

**12-month rating** **Buy**

**12m price target** **Rmb49.00**

**Price** **Rmb40.47**

**RIC:** 600594.SS **BBG:** 600594 CH

### Trading data and key metrics

**52-wk range** Rmb42.99-28.35

**Market cap.** Rmb14.6bn/US\$2.38bn

**Shares o/s** 361m (ORDA)

**Free float** 64%

**Avg. daily volume ('000)** 1,356

**Avg. daily value (m)** Rmb53.6

**Common s/h equity (12/14E)** Rmb3.61bn

**P/BV (12/14E)** 4.4x

**Net debt / EBITDA (12/14E)** NM

### EPS (UBS, diluted) (Rmb)

	UBS	Cons.
<b>12/14E</b>	1.45	1.42
<b>12/15E</b>	1.85	1.84
<b>12/16E</b>	2.44	2.38

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Highlights (Rmbm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	1,903	2,253	2,785	3,565	4,563	5,840	7,300	9,126
EBIT (UBS)	339	401	545	791	992	1,299	1,624	2,030
Net earnings (UBS)	254	314	411	573	733	966	1,269	1,586
EPS (UBS, diluted) (Rmb)	0.72	0.87	1.14	1.45	1.85	2.44	3.20	4.01
DPS (Rmb)	0.03	0.03	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(65)	(109)	(209)	1,165	1,761	2,658	3,488	4,575
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	17.8	17.8	19.6	22.2	21.8	22.3	22.3	22.3
ROIC (EBIT) %	31.8	28.8	29.5	35.3	40.2	50.4	57.1	61.1
EV/EBITDA (core) x	17.0	14.9	17.9	16.0	12.3	8.8	6.6	4.8
P/E (UBS, diluted) x	26.1	21.3	25.8	28.0	21.9	16.6	12.6	10.1
Equity FCF (UBS) yield %	6.1	6.2	2.7	1.8	3.8	5.7	5.1	6.6
Net dividend yield %	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rmb40.47 on 15 Aug 2014 22:37 HKT



# Investment Thesis

## Yibai Pharma

### Investment case

We believe Yibai is skilled at choosing and acquiring products, and at marketing. Its competitiveness fell in 2007-12 due to a lack of new products and an ageing product mix. We believe conditions have improved: major products such as Aidi and Xingding have maintained steady growth; sales of tier-2 products such as Lobaplatin and Reteplase could begin to ramp up after long-term marketing and should become the most important earnings drivers in the next five years. It has also acquired a few promising traditional Chinese medicines via M&A, providing further support for Yibai's earnings growth. We estimate a 33% net profit CAGR in the next three years, which may continue to beat market expectations, in turn pushing up valuation. We have a Buy rating.

### Upside scenario

Our upside scenario assumes Rmb4.06bn in revenue in 2014 due to the quick ramping up of Lobaplatin and Reteplase. Based on this, we arrive at our upside valuation of Rmb52.40, which is based on our upside 2014E EPS of Rmb1.55.

### Downside scenario

Assuming revenues do not grow as quickly as expected in 2014, we assume Rmb3.45bn in revenue for our downside scenario. Therefore, our 2014 EPS estimate is Rmb1.36 and our downside valuation is Rmb39.44.

### Upcoming catalysts

Reteplase capacity becomes operational;

Better-than-expected acceleration in Rx drugs revenue growth in 2014.

12-month rating

**Buy**

12m price target

**Rmb49.00**

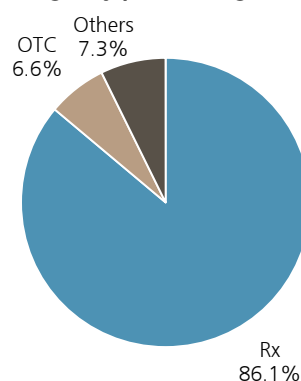
### Business description

In its early years, Guizhou Yibai Pharmaceutical's core business was over-the-counter (OTC) treatments, complemented by prescription drugs. It has shifted its focus to prescription medicines in recent years, the two major areas being anti-tumour and cardiovascular medicines.

### Industry outlook

China's medicine market entered an era of 'product is king' from 2007, with medical demand increasing year by year and the threshold for medicine approvals becoming tougher. Therefore, the outlook for companies with strong product acquisition capability is more promising, in our view.

### Gross margin by product segment (2013)



Source: Company data

### Revenues by product segment

Rmb m	2012	2013	2014E	2015E	2016E
Rx	1616	2112	2750	3610	4622
OTC	168	114	110	110	120
Others	51	62	117	67	105
<b>Total</b>	<b>1835</b>	<b>2288</b>	<b>2977</b>	<b>3787</b>	<b>4847</b>

Source: Company data, UBS-S estimates

## Guizhou Yibai Pharmaceutical (600594.SS)

Income statement (Rmbm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
<b>Revenues</b>	<b>1,903</b>	<b>2,253</b>	<b>2,785</b>	<b>3,565</b>	<b>28.0</b>	<b>4,563</b>	<b>28.0</b>	<b>5,840</b>	<b>7,300</b>	<b>9,126</b>
Gross profit	1,576	1,835	2,288	2,977	30.1	3,787	27.2	4,847	6,059	7,574
<b>EBITDA (UBS)</b>	<b>392</b>	<b>453</b>	<b>600</b>	<b>837</b>	<b>39.4</b>	<b>1,044</b>	<b>24.7</b>	<b>1,354</b>	<b>1,681</b>	<b>2,090</b>
Depreciation & amortisation	(52)	(52)	(55)	(46)	-17.4	(52)	13.1	(54)	(57)	(60)
<b>EBIT (UBS)</b>	<b>339</b>	<b>401</b>	<b>545</b>	<b>791</b>	<b>45.2</b>	<b>992</b>	<b>25.4</b>	<b>1,299</b>	<b>1,624</b>	<b>2,030</b>
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	(7)	0	(16)	0	-	(10)	-	(10)	(7)	(14)
Net interest	(22)	(21)	(36)	8	-	43	NM	66	92	120
Exceptionals (incl goodwill)	14	23	22	0	-	0	-	0	0	0
<b>Profit before tax</b>	<b>325</b>	<b>404</b>	<b>515</b>	<b>799</b>	<b>55.1</b>	<b>1,026</b>	<b>28.4</b>	<b>1,355</b>	<b>1,709</b>	<b>2,137</b>
Tax	(57)	(65)	(84)	(224)	-164.9	(287)	-28.4	(379)	(427)	(534)
<b>Profit after tax</b>	<b>268</b>	<b>339</b>	<b>431</b>	<b>575</b>	<b>33.5</b>	<b>739</b>	<b>28.4</b>	<b>976</b>	<b>1,281</b>	<b>1,602</b>
Preference dividends and Minorities	(2)	(5)	(2)	(3)	-55.0	(6)	-92.5	(10)	(13)	(16)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
<b>Net earnings (local GAAP)</b>	<b>265</b>	<b>333</b>	<b>429</b>	<b>573</b>	<b>33.4</b>	<b>733</b>	<b>28.0</b>	<b>966</b>	<b>1,269</b>	<b>1,586</b>
<b>Net earnings (UBS)</b>	<b>254</b>	<b>314</b>	<b>411</b>	<b>573</b>	<b>39.4</b>	<b>733</b>	<b>28.0</b>	<b>966</b>	<b>1,269</b>	<b>1,586</b>
Tax rate (%)	17.6	16.1	16.4	28.0	70.9	28.0	0.0	28.0	25.0	25.0
<b>Per share (Rmb)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
EPS (UBS, diluted)	0.72	0.87	1.14	1.45	27.0	1.85	28.0	2.44	3.20	4.01
EPS (local GAAP, diluted)	0.75	0.92	1.19	1.45	21.5	1.85	28.0	2.44	3.20	4.01
EPS (UBS, basic)	0.72	0.87	1.14	1.45	27.0	1.85	28.0	2.44	3.20	4.01
Net DPS (Rmb)	0.03	0.03	0.00	0.00	-	0.00	-	0.00	0.00	0.00
Book value per share	3.19	4.27	5.33	9.10	70.7	10.96	20.3	13.39	16.60	20.60
Average shares (diluted)	352.76	360.70	360.63	396.00	9.8	396.00	0.0	396.00	396.00	396.00
<b>Balance sheet (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Cash and equivalents	165	192	149	1,186	NM	1,782	50.3	2,679	3,509	4,596
Other current assets	1,090	1,543	1,758	1,378	-21.6	1,541	11.9	1,679	2,219	2,827
<b>Total current assets</b>	<b>1,255</b>	<b>1,735</b>	<b>1,906</b>	<b>2,564</b>	<b>34.5</b>	<b>3,323</b>	<b>29.6</b>	<b>4,358</b>	<b>5,728</b>	<b>7,423</b>
Net tangible fixed assets	245	229	452	639	41.3	708	10.9	702	695	687
Net intangible fixed assets	155	135	144	158	9.5	173	9.5	190	208	228
Investments / other assets	148	178	698	690	-1.1	684	-0.9	680	676	673
<b>Total assets</b>	<b>1,804</b>	<b>2,277</b>	<b>3,201</b>	<b>4,051</b>	<b>26.6</b>	<b>4,889</b>	<b>20.7</b>	<b>5,930</b>	<b>7,307</b>	<b>9,011</b>
Trade payables & other ST liabilities	413	406	876	378	-56.8	478	26.3	543	639	741
Short term debt	229	251	337	0	-	0	-	0	0	0
<b>Total current liabilities</b>	<b>642</b>	<b>656</b>	<b>1,213</b>	<b>378</b>	<b>-68.8</b>	<b>478</b>	<b>26.3</b>	<b>543</b>	<b>639</b>	<b>741</b>
Long term debt	1	51	21	21	0.0	21	0.0	21	21	21
Other long term liabilities	22	24	35	35	0.0	35	0.0	35	35	35
Preferred shares	0	0	0	0	-	0	-	0	0	0
<b>Total liabilities (incl pref shares)</b>	<b>666</b>	<b>731</b>	<b>1,268</b>	<b>434</b>	<b>-65.8</b>	<b>534</b>	<b>22.9</b>	<b>599</b>	<b>695</b>	<b>796</b>
Common s/h equity	1,126	1,539	1,924	3,605	87.4	4,339	20.3	5,304	6,573	8,159
Minority interests	12	7	9	12	33.3	17	48.1	27	40	56
<b>Total liabilities &amp; equity</b>	<b>1,804</b>	<b>2,277</b>	<b>3,201</b>	<b>4,051</b>	<b>26.6</b>	<b>4,889</b>	<b>20.7</b>	<b>5,930</b>	<b>7,307</b>	<b>9,011</b>
<b>Cash flow (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net income (before pref divs)	265	333	429	573	33.4	733	28.0	966	1,269	1,586
Depreciation & amortisation	52	52	55	46	-17.4	52	13.1	54	57	60
Net change in working capital	(195)	(466)	385	(118)	-	(74)	37.5	(83)	(451)	(520)
Other operating	420	702	(306)	(5)	98.3	(28)	NM	(46)	(71)	(90)
<b>Operating cash flow</b>	<b>543</b>	<b>621</b>	<b>564</b>	<b>496</b>	<b>-12.1</b>	<b>683</b>	<b>37.9</b>	<b>891</b>	<b>803</b>	<b>1,035</b>
Tangible capital expenditure	(142)	(210)	(273)	(239)	12.7	(130)	45.4	(60)	(64)	(69)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	(4)	5	7	0	-	0	-	0	0	0
Other investing	38	(63)	(468)	0	-	0	-	0	0	0
<b>Investing cash flow</b>	<b>(108)</b>	<b>(267)</b>	<b>(734)</b>	<b>(239)</b>	<b>67.5</b>	<b>(130)</b>	<b>45.4</b>	<b>(60)</b>	<b>(64)</b>	<b>(69)</b>
Equity dividends paid	(10)	(10)	0	0	-	0	-	0	0	0
Share issues / (buybacks)	0	0	47	1,109	NM	0	-	0	0	0
Other financing	(20)	18	(90)	8	-	43	453.08	66	92	120
Change in debt & pref shares	(41)	72	56	(337)	-	0	-	0	0	0
<b>Financing cash flow</b>	<b>(71)</b>	<b>79</b>	<b>13</b>	<b>780</b>	<b>NM</b>	<b>43</b>	<b>-94.5</b>	<b>66</b>	<b>92</b>	<b>120</b>
<b>Cash flow inc/(dec) in cash</b>	<b>365</b>	<b>433</b>	<b>(157)</b>	<b>1,037</b>	<b>-</b>	<b>596</b>	<b>-42.5</b>	<b>896</b>	<b>830</b>	<b>1,087</b>
FX / non cash items	(390)	(405)	113	0	-99.9	0	0.0	0	0	0
<b>Balance sheet inc/(dec) in cash</b>	<b>(25)</b>	<b>28</b>	<b>(44)</b>	<b>1,037</b>	<b>-</b>	<b>596</b>	<b>-42.5</b>	<b>896</b>	<b>830</b>	<b>1,087</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## Guizhou Yibai Pharmaceutical (600594.SS)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	24.9	20.1	24.7	28.0	21.9	16.6	12.6	10.1
P/E (UBS, diluted)	26.1	21.3	25.8	28.0	21.9	16.6	12.6	10.1
P/CEPS	21.6	18.3	22.8	25.9	20.4	15.7	12.1	9.7
Equity FCF (UBS) yield %	6.1	6.2	2.7	1.8	3.8	5.7	5.1	6.6
Net dividend yield (%)	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0
P/BV x	5.9	4.4	5.5	4.4	3.7	3.0	2.4	2.0
EV/revenues (core)	3.5	3.0	3.9	3.8	2.8	2.0	1.5	1.1
EV/EBITDA (core)	17.0	14.9	17.9	16.0	12.3	8.8	6.6	4.8
EV/EBIT (core)	19.6	16.8	19.8	16.9	12.9	9.2	6.8	4.9
EV/OpFCF (core)	20.5	21.2	17.3	17.5	12.8	9.0	7.0	5.1
EV/op. invested capital	6.2	4.9	5.8	6.0	5.2	4.6	3.9	3.0
<b>Enterprise value (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Market cap.	6,608	6,684	10,615	14,600	14,600	14,600	14,600	14,600
Net debt (cash)	65	109	209	(1,165)	(1,761)	(2,658)	(3,488)	(4,575)
Buy out of minorities	12	7	9	12	17	27	40	56
Pension provisions/other	0	0	0	0	0	0	0	0
<b>Total enterprise value</b>	<b>6,685</b>	<b>6,799</b>	<b>10,832</b>	<b>13,447</b>	<b>12,856</b>	<b>11,969</b>	<b>11,152</b>	<b>10,081</b>
Non core assets	(27)	(46)	(56)	(56)	(56)	(56)	(56)	(56)
<b>Core enterprise value</b>	<b>6,658</b>	<b>6,753</b>	<b>10,776</b>	<b>13,391</b>	<b>12,800</b>	<b>11,913</b>	<b>11,096</b>	<b>10,024</b>
<b>Growth (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Revenue	29.7	18.3	23.6	28.0	28.0	28.0	25.0	25.0
EBITDA (UBS)	20.2	15.7	32.5	39.4	24.7	29.7	24.2	24.3
EBIT (UBS)	21.9	18.3	35.8	45.2	25.4	30.9	25.0	25.0
EPS (UBS, diluted)	24.8	21.1	30.8	27.0	28.0	31.7	31.4	25.1
Net DPS	-60.0	-2.2	-	-	-	-	-	-
<b>Margins &amp; Profitability (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Gross profit margin	NM	NM	NM	NM	NM	NM	NM	NM
EBITDA margin	20.6	20.1	21.6	23.5	22.9	23.2	23.0	22.9
EBIT margin	17.8	17.8	19.6	22.2	21.8	22.3	22.3	22.3
Net earnings (UBS) margin	13.3	13.9	14.7	16.1	16.1	16.5	17.4	17.4
ROIC (EBIT)	31.8	28.8	29.5	35.3	40.2	50.4	57.1	61.1
ROIC post tax	26.2	24.2	24.7	25.4	29.0	36.3	42.9	45.8
ROE (UBS)	25.5	23.6	23.7	20.7	18.5	20.0	21.4	21.5
<b>Capital structure &amp; Coverage (x)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net debt / EBITDA	0.2	0.2	0.3	(1.4)	(1.7)	(2.0)	(2.1)	(2.2)
Net debt / total equity %	5.7	7.1	10.8	(32.2)	(40.4)	(49.9)	(52.8)	(55.7)
Net debt / (net debt + total equity) %	5.4	6.6	9.8	(47.5)	(67.9)	(99.4)	NM	NM
Net debt/EV	1.0	1.6	1.9	(8.7)	(13.8)	(22.3)	(31.4)	(45.6)
Capex / depreciation %	NM	NM	NM	NM	NM	113.8	115.9	118.3
Capex / revenue %	7.5	9.3	9.8	6.7	2.9	1.0	0.9	0.8
EBIT / net interest	15.6	19.3	15.0	NM	NM	NM	NM	NM
Dividend cover (UBS)	24.4	NM	-	-	-	-	-	-
Div. payout ratio (UBS) %	4.1	3.3	-	-	-	-	-	-
<b>Revenues by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	1,903	2,253	2,785	3,565	4,563	5,840	7,300	9,126
<b>Total</b>	<b>1,903</b>	<b>2,253</b>	<b>2,785</b>	<b>3,565</b>	<b>4,563</b>	<b>5,840</b>	<b>7,300</b>	<b>9,126</b>
<b>EBIT (UBS) by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	339	401	545	791	992	1,299	1,624	2,030
<b>Total</b>	<b>339</b>	<b>401</b>	<b>545</b>	<b>791</b>	<b>992</b>	<b>1,299</b>	<b>1,624</b>	<b>2,030</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

# Tonghua Dongbao Pharmaceutical

## A leading second-generation insulin manufacturer

### A leading insulin manufacturer in China

Dongbao's main products portfolio consists of second-generation recombinant human insulin bulk drugs and injections, zhennaoning capsules as well as dongbao gantai tablets, among others. It is a leading company in the domestic insulin field and focuses on the primary care market. We believe volume in the primary insulin market will increase rapidly in the next 2-3 years. The company's third-generation insulin has obtained approval for clinical trials and is likely to be approved by the China Food and Drug Administration (CFDA) in 2016. This will effectively supplement its product line once the product is launched.

### Dongbao as the main beneficiary of the primary insulin market's ramp up

The firm moved into the primary care market in 2009. We estimate that it covers 4,000+ prefectural/county-level hospitals, with full coverage of these hospitals likely in the future. As Dongbao has focussed on building its marketing network and educating doctors in the primary care market for some time, it should be the main beneficiary as the primary insulin market rapidly ramps up volumes.

### Bullish on Dongbao's development potential as China has many diabetics

China has the most diabetic patients in the world at c92.4m in 2012. The large patient base should create a major market for anti-diabetic drugs. As it is a leading insulin firm in China, with the launch of insulin analogues and oral anti-diabetic drugs onto the market in future, Dongbao will likely become a global insulin specialist that can match Novo Nordisk and Eli Lilly, in our view.

### Valuation: Rmb16.36 PT, Buy rating

We estimate the company's 2014/2015/2016 EPS at Rmb0.33/0.46/0.58. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCM tool (assuming an 8.5% WACC).

### Equities

China  
Pharmaceuticals

**12-month rating** **Buy**

**12m price target** **Rmb16.36**

**Price** **Rmb13.40**

**RIC:** 600867.SS **BBG:** 600867 CH

### Trading data and key metrics

<b>52-wk range</b>	Rmb16.25-10.36
<b>Market cap.</b>	Rmb13.7bn/US\$2.23bn
<b>Shares o/s</b>	1,025m (ORDA)
<b>Free float</b>	61%
<b>Avg. daily volume ('000)</b>	7,853
<b>Avg. daily value (m)</b>	Rmb99.2
<b>Common s/h equity (12/14E)</b>	Rmb2.11bn
<b>P/BV (12/14E)</b>	6.5x
<b>Net debt / EBITDA (12/14E)</b>	1.3x

### EPS (UBS, diluted) (Rmb)

	UBS	Cons.
<b>12/14E</b>	0.33	0.27
<b>12/15E</b>	0.46	0.35
<b>12/16E</b>	0.58	0.48

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Highlights (Rmbm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	784	992	1,204	1,567	2,007	2,509	3,137	3,921
EBIT (UBS)	55	134	226	558	645	824	999	1,229
Net earnings (UBS)	361	47	188	304	426	542	552	688
EPS (UBS, diluted) (Rmb)	0.39	0.05	0.20	0.33	0.46	0.58	0.59	0.74
DPS (Rmb)	0.17	0.17	0.20	0.14	0.20	0.25	0.25	0.32
Net (debt) / cash	59	(193)	(293)	(919)	(1,131)	(1,311)	(1,568)	(1,795)
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	7.0	13.5	18.8	35.6	32.1	32.9	31.9	31.4
ROIC (EBIT) %	3.0	6.9	11.0	22.5	20.7	22.5	23.5	25.0
EV/EBITDA (core) x	44.7	27.2	38.7	19.8	17.7	14.5	12.4	10.5
P/E (UBS, diluted) x	18.6	NM	62.4	41.1	29.3	23.0	22.6	18.1
Equity FCF (UBS) yield %	3.0	0.2	0.2	(2.9)	(0.1)	0.6	0.5	0.9
Net dividend yield %	2.3	2.6	1.6	1.0	1.5	1.9	1.9	2.4

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rmb13.40 on 15 Aug 2014 22:37 HKT

# Investment Thesis

## Tonghua Dongbao

### Investment case

Dongbao is a leading company in the domestic second-generation insulin field. We estimate it covers over 4,000 county-level hospitals, with full coverage of such hospitals likely in the future. We believe that primary-care insulin will post the highest growth in the insulin market in the next few years, and Dongbao will benefit the most. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool (assuming a WACC of 8.5%). We have a Buy rating on the company.

### Upside scenario

In our upside scenario, assuming sales of Rmb1.6bn, up 35% YoY, our 2014E EPS would be Rmb0.36, 9% higher than our estimate, implying an upside valuation of Rmb17.80.

### Downside scenario

Our downside case assumes sales at only Rmb1.5bn, up 25% YoY, and a 2014E EPS of Rmb0.30, implying a downside valuation of Rmb12.40.

### Upcoming catalysts

1) More provinces launch a new round of essential drug tenders, and Dongbao wins these tenders. The primary market expands rapidly;

2) Clinical trials of insulin analogues go well and Dongbao acquires production permission as expected.

12-month rating

**Buy**

12m price target

**Rmb16.36**

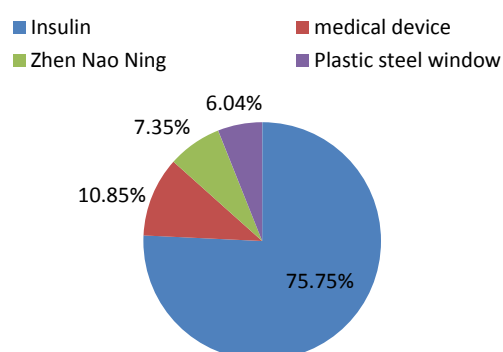
### Business description

Tonghua Dongbao Pharmaceutical is mainly engaged in pharmaceutical manufacturing and distribution as well as the sales of building materials. The company's main products include drugs such as active pharmaceutical ingredients (API) and injections of recombinant human insulin, Zhennaoning capsules and Dongbaogantai tablets, as well as building materials such as plastic steel doors, windows and sections. Its products are sold in domestic and overseas markets.

### Industry outlook

As China's population is ageing, the incidence of diabetes has risen from 4.3% in 2007 to 9.4% in 2012. We expect insulin producers to benefit from the sharp increase in the number of diabetic patients.

### Revenues by product segment (2013)



Source: Company data

### Gross profit by segment

Rmb m	2012	2013	2014E	2015E	2016E
Insulin	553	654	934	1,242	1581
Zhen Nao Ning	53	56	60	65	60
Other	29	109	35	44	40
<b>Total</b>	<b>634</b>	<b>819</b>	<b>1029</b>	<b>1351</b>	<b>1681</b>

Source: Company data, UBS-S estimates

## Tonghua Dongbao Pharmaceutical (600867.SS)

Income statement (Rmbm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
<b>Revenues</b>	<b>784</b>	<b>992</b>	<b>1,204</b>	<b>1,567</b>	<b>30.1</b>	<b>2,007</b>	<b>28.1</b>	<b>2,509</b>	<b>3,137</b>	<b>3,921</b>
Gross profit	489	634	819	1,029	25.7	1,351	31.2	1,681	2,102	2,627
<b>EBITDA (UBS)</b>	<b>161</b>	<b>242</b>	<b>336</b>	<b>729</b>	<b>117.3</b>	<b>831</b>	<b>13.9</b>	<b>1,028</b>	<b>1,224</b>	<b>1,479</b>
Depreciation & amortisation	(107)	(109)	(109)	(172)	56.8	(186)	8.2	(204)	(225)	(250)
<b>EBIT (UBS)</b>	<b>55</b>	<b>134</b>	<b>226</b>	<b>558</b>	<b>146.5</b>	<b>645</b>	<b>15.7</b>	<b>824</b>	<b>999</b>	<b>1,229</b>
Associates & investment income	10	7	9	9	0.0	9	0.0	9	9	9
Other non-operating income	373	(78)	(1)	(166)	NM	(85)	48.9	(115)	(141)	(165)
Net interest	(14)	(14)	(18)	(42)	-139.9	(67)	-56.9	(80)	(94)	(111)
Exceptionals (incl goodwill)	4	18	(5)	0	-	0	-	0	0	0
<b>Profit before tax</b>	<b>427</b>	<b>67</b>	<b>212</b>	<b>358</b>	<b>69.3</b>	<b>503</b>	<b>40.3</b>	<b>639</b>	<b>772</b>	<b>963</b>
Tax	(64)	(7)	(32)	(39)	-22.0	(55)	-40.3	(70)	(193)	(241)
<b>Profit after tax</b>	<b>363</b>	<b>60</b>	<b>179</b>	<b>319</b>	<b>77.8</b>	<b>448</b>	<b>40.3</b>	<b>569</b>	<b>579</b>	<b>722</b>
Preference dividends and Minorities	1	3	4	(15)	-	(21)	-40.3	(27)	(27)	(34)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
<b>Net earnings (local GAAP)</b>	<b>364</b>	<b>63</b>	<b>184</b>	<b>304</b>	<b>65.3</b>	<b>426</b>	<b>40.3</b>	<b>542</b>	<b>552</b>	<b>688</b>
<b>Net earnings (UBS)</b>	<b>361</b>	<b>47</b>	<b>188</b>	<b>304</b>	<b>61.7</b>	<b>426</b>	<b>40.3</b>	<b>542</b>	<b>552</b>	<b>688</b>
Tax rate (%)	15.0	11.1	15.3	11.0	-27.9	11.0	0.0	11.0	25.0	25.0
<b>Per share (Rmb)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
EPS (UBS, diluted)	0.39	0.05	0.20	0.33	61.7	0.46	40.3	0.58	0.59	0.74
EPS (local GAAP, diluted)	0.39	0.07	0.20	0.33	65.3	0.46	40.3	0.58	0.59	0.74
EPS (UBS, basic)	0.39	0.05	0.20	0.33	61.7	0.46	40.3	0.58	0.59	0.74
Net DPS (Rmb)	0.17	0.17	0.20	0.14	-30.4	0.20	40.3	0.25	0.25	0.32
Book value per share	2.00	1.91	1.94	2.06	5.9	2.35	14.1	2.70	3.01	3.45
Average shares (diluted)	931.50	931.50	931.46	931.46	0.0	931.46	0.0	931.46	931.46	931.46
<b>Balance sheet (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Cash and equivalents	244	125	216	31	-85.5	40	28.1	50	63	78
Other current assets	810	744	891	786	-11.8	1,028	30.9	1,294	1,590	1,999
<b>Total current assets</b>	<b>1,054</b>	<b>869</b>	<b>1,107</b>	<b>817</b>	<b>-26.2</b>	<b>1,069</b>	<b>30.8</b>	<b>1,344</b>	<b>1,653</b>	<b>2,077</b>
Net tangible fixed assets	1,086	1,033	954	1,518	59.1	1,601	5.5	1,726	1,877	2,053
Net intangible fixed assets	69	69	65	64	-0.6	64	-0.7	63	63	62
Investments / other assets	168	410	568	828	45.8	1,053	27.2	1,251	1,428	1,591
<b>Total assets</b>	<b>2,377</b>	<b>2,380</b>	<b>2,694</b>	<b>3,228</b>	<b>19.8</b>	<b>3,786</b>	<b>17.3</b>	<b>4,384</b>	<b>5,021</b>	<b>5,783</b>
Trade payables & other ST liabilities	100	57	122	74	-39.4	94	26.6	115	141	174
Short term debt	63	79	253	694	174.13	915	31.89	1,105	1,375	1,618
<b>Total current liabilities</b>	<b>163</b>	<b>136</b>	<b>375</b>	<b>768</b>	<b>104.7</b>	<b>1,008</b>	<b>31.4</b>	<b>1,219</b>	<b>1,516</b>	<b>1,791</b>
Long term debt	122	239	256	256	0.0	256	0.0	256	256	256
Other long term liabilities	14	14	47	55	17.0	55	0.0	55	47	47
Preferred shares	0	0	0	0	-	0	-	0	0	0
<b>Total liabilities (incl pref shares)</b>	<b>299</b>	<b>389</b>	<b>678</b>	<b>1,079</b>	<b>59.0</b>	<b>1,320</b>	<b>22.3</b>	<b>1,530</b>	<b>1,819</b>	<b>2,094</b>
Common s/h equity	2,046	1,962	1,991	2,109	5.9	2,406	14.1	2,766	3,087	3,539
Minority interests	32	29	25	40	59.9	61	52.5	88	115	149
<b>Total liabilities &amp; equity</b>	<b>2,377</b>	<b>2,380</b>	<b>2,694</b>	<b>3,228</b>	<b>19.8</b>	<b>3,786</b>	<b>17.3</b>	<b>4,384</b>	<b>5,021</b>	<b>5,783</b>
<b>Cash flow (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net income (before pref divs)	364	63	184	304	65.3	426	40.3	542	552	688
Depreciation & amortisation	107	109	109	172	56.8	186	8.2	204	225	250
Net change in working capital	(66)	158	0	(92)	-	(299)	-226.2	(350)	(410)	(532)
Other operating	(96)	(72)	(79)	214	-	163	-23.8	212	254	300
<b>Operating cash flow</b>	<b>309</b>	<b>257</b>	<b>215</b>	<b>598</b>	<b>178.8</b>	<b>477</b>	<b>-20.3</b>	<b>608</b>	<b>621</b>	<b>706</b>
Tangible capital expenditure	(89)	(242)	(190)	(992)	NM	(489)	50.7	(521)	(547)	(580)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	406	8	6	0	-	0	-	0	0	0
Other investing	50	(11)	16	(3)	-	(4)	-	(5)	(6)	(7)
<b>Investing cash flow</b>	<b>367</b>	<b>(245)</b>	<b>(168)</b>	<b>(995)</b>	<b>NM</b>	<b>(493)</b>	<b>50.4</b>	<b>(526)</b>	<b>(553)</b>	<b>(587)</b>
Equity dividends paid	0	(155)	(155)	(186)	-20.0	(130)	30.4	(182)	(231)	(235)
Share issues / (buybacks)	0	0	1	0	-	0	-	0	0	0
Other financing	20	(45)	2	(42)	-	(67)	-56.90	(80)	(94)	(111)
Change in debt & pref shares	(146)	133	192	441	129.94	221	-49.79	190	270	243
<b>Financing cash flow</b>	<b>(125)</b>	<b>(68)</b>	<b>39</b>	<b>212</b>	<b>NM</b>	<b>25</b>	<b>-88.2</b>	<b>(72)</b>	<b>(55)</b>	<b>(103)</b>
<b>Cash flow inc/(dec) in cash</b>	<b>551</b>	<b>(56)</b>	<b>85</b>	<b>(185)</b>	<b>-</b>	<b>9</b>	<b>-</b>	<b>10</b>	<b>13</b>	<b>16</b>
FX / non cash items	(370)	(64)	6	0	-	0	-	0	0	0
<b>Balance sheet inc/(dec) in cash</b>	<b>181</b>	<b>(119)</b>	<b>91</b>	<b>(185)</b>	<b>-</b>	<b>9</b>	<b>-</b>	<b>10</b>	<b>13</b>	<b>16</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## Tonghua Dongbao Pharmaceutical (600867.SS)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	18.4	NM	63.7	41.1	29.3	23.0	22.6	18.1
P/E (UBS, diluted)	18.6	NM	62.4	41.1	29.3	23.0	22.6	18.1
P/CEPS	14.4	38.4	39.4	26.2	20.4	16.7	16.1	13.3
Equity FCF (UBS) yield %	3.0	0.2	0.2	(2.9)	(0.1)	0.6	0.5	0.9
Net dividend yield (%)	2.3	2.6	1.6	1.0	1.5	1.9	1.9	2.4
P/BV x	3.6	3.3	6.5	6.5	5.7	5.0	4.4	3.9
EV/revenues (core)	9.2	6.7	NM	9.2	7.3	5.9	4.8	3.9
EV/EBITDA (core)	44.7	27.2	38.7	19.8	17.7	14.5	12.4	10.5
EV/EBIT (core)	NM	NM	NM	26.0	22.8	18.1	15.2	12.6
EV/OpFCF (core)	NM	29.3	NM	28.2	21.8	17.5	14.7	12.3
EV/op. invested capital	3.9	3.4	6.3	5.8	4.7	4.1	3.6	3.1
<b>Enterprise value (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Market cap.	7,385	6,553	12,897	13,730	13,730	13,730	13,730	13,730
Net debt (cash)	(59)	193	293	919	1,131	1,311	1,568	1,795
Buy out of minorities	32	29	25	40	61	88	115	149
Pension provisions/other	0	0	0	0	0	0	0	0
<b>Total enterprise value</b>	<b>7,358</b>	<b>6,776</b>	<b>13,215</b>	<b>14,688</b>	<b>14,922</b>	<b>15,128</b>	<b>15,413</b>	<b>15,674</b>
Non core assets	(139)	(173)	(213)	(213)	(213)	(213)	(213)	(213)
<b>Core enterprise value</b>	<b>7,219</b>	<b>6,603</b>	<b>13,002</b>	<b>14,475</b>	<b>14,708</b>	<b>14,915</b>	<b>15,200</b>	<b>15,461</b>
<b>Growth (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Revenue	23.0	26.4	21.5	30.1	28.1	25.0	25.0	25.0
EBITDA (UBS)	-7.2	50.2	38.5	117.3	13.9	23.7	19.1	20.8
EBIT (UBS)	-22.2	144.3	69.2	146.5	15.7	27.8	21.2	23.0
EPS (UBS, diluted)	111.0	-87.1	NM	61.7	40.3	27.1	1.9	24.7
Net DPS	-	0.0	20.0	-30.4	40.3	27.1	1.9	24.7
<b>Margins &amp; Profitability (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Gross profit margin	62.3	64.0	68.0	65.7	67.3	67.0	67.0	67.0
EBITDA margin	20.6	24.4	27.9	46.5	41.4	41.0	39.0	37.7
EBIT margin	7.0	13.5	18.8	35.6	32.1	32.9	31.9	31.4
Net earnings (UBS) margin	46.0	4.7	15.6	19.4	21.2	21.6	17.6	17.6
ROIC (EBIT)	3.0	6.9	11.0	22.5	20.7	22.5	23.5	25.0
ROIC post tax	2.5	6.0	9.3	20.0	18.4	20.0	17.5	18.7
ROE (UBS)	19.3	2.3	9.5	14.8	18.9	21.0	18.9	20.8
<b>Capital structure &amp; Coverage (x)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net debt / EBITDA	(0.4)	0.8	0.9	1.3	1.4	1.3	1.3	1.2
Net debt / total equity %	(2.8)	9.7	14.5	42.7	45.8	45.9	49.0	48.7
Net debt / (net debt + total equity) %	(2.9)	8.8	12.7	29.9	31.4	31.5	32.9	32.7
Net debt/EV	(0.8)	2.9	2.3	6.3	7.7	8.8	10.3	11.6
Capex / depreciation %	90.6	NM	190.6	NM	NM	NM	NM	NM
Capex / revenue %	11.3	24.4	15.8	NM	24.4	20.8	17.5	14.8
EBIT / net interest	3.8	9.4	12.8	13.1	9.7	10.3	10.6	11.1
Dividend cover (UBS)	2.3	0.3	1.0	2.3	2.3	2.3	2.3	2.3
Div. payout ratio (UBS) %	43.0	NM	99.1	42.7	42.7	42.7	42.7	42.7
<b>Revenues by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	784	992	1,204	1,567	2,007	2,509	3,137	3,921
<b>Total</b>	<b>784</b>	<b>992</b>	<b>1,204</b>	<b>1,567</b>	<b>2,007</b>	<b>2,509</b>	<b>3,137</b>	<b>3,921</b>
<b>EBIT (UBS) by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	55	134	226	558	645	824	999	1,229
<b>Total</b>	<b>55</b>	<b>134</b>	<b>226</b>	<b>558</b>	<b>645</b>	<b>824</b>	<b>999</b>	<b>1,229</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

# Shinva Medical Instrument

## China's leading medical device company

### China's leading medical device company

Shinva is a large state-owned enterprise engaged in the design, development, production and sales of medical devices. The company's businesses involve many medical device fields including infection control equipment, pharmaceutical equipment, medical-use environmental protection equipment, air purification equipment, radiation therapy equipment, medical diagnostic imaging equipment, surgical instruments, disposable medical supplies, and sterilisation testing products. The company is in a leading position in infection control equipment, pharmaceutical equipment, medical-use environmental protection equipment, and radiation therapy equipment in China.

### "Organic + inorganic" growth continues to drive Shinva's high growth

With Shinva's involvement in the three major segments of medical devices, healthcare services and pharmaceutical equipment, we believe future inorganic expansion will mainly be medical devices and healthcare services: 1) for medical devices, the main future expansion is in vitro diagnostics and hemodialysis; 2) for healthcare services, it plans to create a medical management group operating in at least 100 hospitals by acquiring hospitals specialised in fields such as orthopedics and cancer; and 3) the company will have basically completed its deployment in the pharmaceutical equipment segment after acquiring Chengdu Yingde.

### Improve performance appraisal/incentive bonuses to focus on growth quality

Shinva has launched a more scientific programme to evaluate economic value added (EVA), net profit growth rate, core revenue growth rate, and accounts receivables + payables + other receivables + stock/revenue, focusing more on growth quality. Management has also pledged to purchase Shinva shares in the secondary market with no less than 50% of received incentive bonuses, ensuring alignment of management and investor interests. We are bullish on the company's long-term growth with incentives in place.

### Valuation: price target of Rmb52.50; Buy rating

We estimate Shinva's 2014/2015/2016 EPS at Rmb0.87/1.26/1.70. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool (assuming a WACC of 6.9%).

### Equities

China  
Healthcare Providers

**12-month rating** **Buy**

**12m price target** **Rmb52.50**

**Price** **Rmb33.87**

**RIC:** 600587.SS **BBG:** 600587 CH

### Trading data and key metrics

<b>52-wk range</b>	Rmb46.60-24.26
<b>Market cap.</b>	Rmb13.5bn/US\$2.19bn
<b>Shares o/s</b>	398m (ORDA)
<b>Free float</b>	60%
<b>Avg. daily volume ('000)</b>	3,846
<b>Avg. daily value (m)</b>	Rmb128.4
<b>Common s/h equity (12/14E)</b>	Rmb2.74bn
<b>P/BV (12/14E)</b>	4.9x
<b>Net debt / EBITDA (12/14E)</b>	NM

### EPS (UBS, diluted) (Rmb)

	UBS	Cons.
<b>12/14E</b>	0.87	0.87
<b>12/15E</b>	1.26	1.21
<b>12/16E</b>	1.70	1.59

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Highlights (Rmbm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	2,106	3,036	4,194	5,572	7,387	9,234	11,173	13,296
EBIT (UBS)	151	238	349	466	673	845	1,022	1,217
Net earnings (UBS)	99	155	210	347	503	676	807	902
EPS (UBS, diluted) (Rmb)	0.33	0.46	0.58	0.87	1.26	1.70	2.03	2.27
DPS (Rmb)	0.06	0.05	0.07	0.11	0.15	0.20	0.24	0.27
Net (debt) / cash	66	99	(144)	724	723	975	1,246	1,551
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	7.2	7.8	8.3	8.4	9.1	9.2	9.2	9.2
ROIC (EBIT) %	24.0	21.3	16.5	18.6	27.4	29.4	31.2	32.4
EV/EBITDA (core) x	24.0	16.7	23.4	25.8	18.2	14.3	11.6	9.6
P/E (UBS, diluted) x	41.1	28.8	40.3	38.8	26.8	19.9	16.7	14.9
Equity FCF (UBS) yield %	(3.4)	(3.8)	(5.9)	4.9	0.1	2.1	2.4	2.7
Net dividend yield %	0.4	0.4	0.3	0.3	0.4	0.6	0.7	0.8

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rmb33.87 on 15 Aug 2014 22:37 HKT



# Investment Thesis

## Shinva Medical

### Investment case

Shinva Medical is mainly engaged in healthcare device and pharmaceutical equipment manufacturing, as well as medical devices. Supported by organic growth and M&A, the company's revenue rose at a CAGR of 48% in 2009-13. Shinva Medical has accumulated adequate channel resources and technologies in the medical device and pharmaceutical equipment fields after years of operation, and is likely to maintain its leading position and rapid growth in these markets by steadily launching new products. The company is bullish on its potential in the healthcare services market and plans continued investment in the future. Shinva Medical is looking to acquire firms that can achieve synergies with its existing business. We are optimistic on the company's long-term growth and assign a Buy rating.

### Upside scenario

If the company's 2014 medical device sales reach Rmb4.5bn, up 39% YoY, we estimate EPS at Rmb0.91, 5% higher than in our current estimate, and an upside valuation of Rmb54.50.

### Downside scenario

If the company's 2014 medical device sales are Rmb3.8bn, up 18% YoY, we estimate EPS at Rmb0.82, 6% lower than in current estimate, and a downside valuation of Rmb49.20.

### Upcoming catalysts

Approval of its acquisition of Chendu Yingde Bio-Engineering Co., is granted by the CSRC.

12-month rating

**Buy**

12m price target

**Rmb52.50**

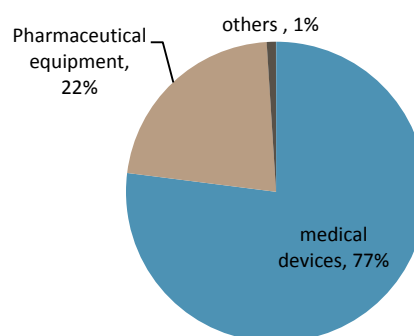
### Business description

Shinva Medical Instrument is engaged in medical instrument and pharmaceutical equipment manufacturing, as well as medical services. Its medical equipment business includes sensing and control equipment, radiotherapeutic devices, surgical and orthopedic consumables, and diagnostic reagents, and it is likely to develop rapidly in the future. Its pharmaceutical equipment mainly includes freeze dryers, sterilizers and non-PVC soft bag filling lines; this business is likely to grow steadily. Currently, its medical services business consists of three special hospitals, and is likely to expand via M&As in the future.

### Industry outlook

Shinva is engaged in medical device and pharmaceutical equipment production, as well as healthcare services. We are bullish on the three businesses: medical devices only account for 14% of China's medical market, but this should rise and approach the global average of 42% in future; China's medical device market is likely to exceed US\$53bn in 2015E; as the medical market is growing, the pharma equipment sub-market is growing rapidly and has good potential, as China is now one of the world's most promising pharma equipment markets; as medical reform deepens, the government is gradually allowing private capital to enter the medical services market to resolve the supply/demand imbalance; we are optimistic about the outlook for private hospitals in China.

### Gross margin by product segment (2013)



Source: Company data

### EBIT by product segment

Rmb m	2012	2013	2014E	2015E	2016E
Pharmaceutical equipment	104	145	164	253	275
Medical devices	553	788	1033	1349	1689
Healthcare services	0	0	35	70	120
Others	35	28	28	14	24
<b>Total</b>	<b>692</b>	<b>961</b>	<b>1260</b>	<b>1686</b>	<b>2108</b>

Source: Company data, UBS-S estimates

## Shinva Medical Instrument (600587.SS)

	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
<b>Income statement (Rmbm)</b>										
<b>Revenues</b>	<b>2,106</b>	<b>3,036</b>	<b>4,194</b>	<b>5,572</b>	<b>32.9</b>	<b>7,387</b>	<b>32.6</b>	<b>9,234</b>	<b>11,173</b>	<b>13,296</b>
Gross profit	480	692	961	1,260	31.1	1,686	33.9	2,108	2,551	3,035
<b>EBITDA (UBS)</b>	<b>170</b>	<b>267</b>	<b>381</b>	<b>502</b>	<b>31.5</b>	<b>712</b>	<b>42.0</b>	<b>887</b>	<b>1,069</b>	<b>1,267</b>
Depreciation & amortisation	(19)	(29)	(33)	(36)	9.7	(39)	9.3	(43)	(46)	(50)
<b>EBIT (UBS)</b>	<b>151</b>	<b>238</b>	<b>349</b>	<b>466</b>	<b>33.5</b>	<b>673</b>	<b>44.5</b>	<b>845</b>	<b>1,022</b>	<b>1,217</b>
Associates & investment income	4	1	0	0	-	0	-	0	0	0
Other non-operating income	(13)	(11)	(11)	(48)	-335.6	(68)	-41.2	(27)	(49)	(58)
Net interest	(7)	(18)	(35)	4	-	23	NM	27	36	45
Exceptionals (incl goodwill)	10	10	27	0	-	0	-	0	0	0
<b>Profit before tax</b>	<b>144</b>	<b>220</b>	<b>330</b>	<b>422</b>	<b>27.9</b>	<b>628</b>	<b>48.9</b>	<b>845</b>	<b>1,009</b>	<b>1,203</b>
Tax	(26)	(39)	(64)	(75)	-18.5	(126)	-66.8	(169)	(202)	(301)
<b>Profit after tax</b>	<b>118</b>	<b>181</b>	<b>266</b>	<b>347</b>	<b>30.1</b>	<b>503</b>	<b>45.0</b>	<b>676</b>	<b>807</b>	<b>902</b>
Preference dividends and Minorities	(10)	(18)	(35)	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
<b>Net earnings (local GAAP)</b>	<b>107</b>	<b>163</b>	<b>232</b>	<b>347</b>	<b>49.7</b>	<b>503</b>	<b>45.0</b>	<b>676</b>	<b>807</b>	<b>902</b>
<b>Net earnings (UBS)</b>	<b>99</b>	<b>155</b>	<b>210</b>	<b>347</b>	<b>65.0</b>	<b>503</b>	<b>45.0</b>	<b>676</b>	<b>807</b>	<b>902</b>
Tax rate (%)	18.2	17.7	19.3	17.8	-7.4	20.0	12.1	20.0	20.0	25.0
<b>Per share (Rmb)</b>										
EPS (UBS, diluted)	0.33	0.46	0.58	0.87	50.3	1.26	45.0	1.70	2.03	2.27
EPS (local GAAP, diluted)	0.36	0.49	0.64	0.87	36.3	1.26	45.0	1.70	2.03	2.27
EPS (UBS, basic)	0.33	0.46	0.58	0.87	50.3	1.26	45.0	1.70	2.03	2.27
Net DPS (Rmb)	0.06	0.05	0.07	0.11	59.5	0.15	45.0	0.20	0.24	0.27
Book value per share	2.63	4.25	6.07	6.88	13.4	8.04	16.8	9.59	11.42	13.44
Average shares (diluted)	148.97	166.64	181.00	198.77	9.8	198.77	0.0	198.77	198.77	198.77
<b>Balance sheet (Rmbm)</b>										
Cash and equivalents	350	713	714	729	2.0	728	-0.1	980	1,251	1,556
Other current assets	1,110	1,721	2,949	2,962	0.4	4,008	35.3	4,929	5,967	7,123
<b>Total current assets</b>	<b>1,460</b>	<b>2,435</b>	<b>3,664</b>	<b>3,691</b>	<b>0.7</b>	<b>4,736</b>	<b>28.3</b>	<b>5,909</b>	<b>7,218</b>	<b>8,679</b>
Net tangible fixed assets	245	378	519	539	3.9	558	3.4	575	592	609
Net intangible fixed assets	71	146	301	214	-28.8	254	18.4	297	345	398
Investments / other assets	177	420	907	576	-36.5	571	-0.9	569	569	571
<b>Total assets</b>	<b>1,952</b>	<b>3,378</b>	<b>5,391</b>	<b>5,020</b>	<b>-6.9</b>	<b>6,119</b>	<b>21.9</b>	<b>7,350</b>	<b>8,724</b>	<b>10,257</b>
Trade payables & other ST liabilities	774	1,112	1,772	1,932	9.0	2,570	33.0	3,185	3,833	4,561
Short term debt	278	608	853	0	-	0	-	0	0	0
<b>Total current liabilities</b>	<b>1,052</b>	<b>1,720</b>	<b>2,625</b>	<b>1,932</b>	<b>-26.4</b>	<b>2,570</b>	<b>33.0</b>	<b>3,185</b>	<b>3,833</b>	<b>4,561</b>
Long term debt	6	6	5	5	0.0	5	0.0	5	5	5
Other long term liabilities	23	27	38	38	0.0	38	0.0	38	38	38
Preferred shares	0	0	0	0	-	0	-	0	0	0
<b>Total liabilities (incl pref shares)</b>	<b>1,081</b>	<b>1,754</b>	<b>2,668</b>	<b>1,975</b>	<b>-26.0</b>	<b>2,612</b>	<b>32.3</b>	<b>3,227</b>	<b>3,876</b>	<b>4,603</b>
Common s/h equity	789	1,478	2,413	2,736	13.4	3,197	16.8	3,813	4,539	5,344
Minority interests	82	146	310	310	0.0	310	0.0	310	310	310
<b>Total liabilities &amp; equity</b>	<b>1,952</b>	<b>3,378</b>	<b>5,391</b>	<b>5,020</b>	<b>-6.9</b>	<b>6,119</b>	<b>21.9</b>	<b>7,350</b>	<b>8,724</b>	<b>10,257</b>
<b>Cash flow (Rmbm)</b>										
Net income (before pref divs)	107	163	232	347	49.7	503	45.0	676	807	902
Depreciation & amortisation	19	29	33	36	9.7	39	9.3	43	46	50
Net change in working capital	(153)	(322)	(612)	(92)	85.0	(555)	NM	530	549	627
Other operating	4	142	370	447	20.9	123	-72.6	(862)	(975)	(1,100)
<b>Operating cash flow</b>	<b>(22)</b>	<b>12</b>	<b>22</b>	<b>738</b>	<b>NM</b>	<b>110</b>	<b>-85.2</b>	<b>386</b>	<b>428</b>	<b>480</b>
Tangible capital expenditure	(117)	(184)	(528)	(84)	84.2	(92)	-10.0	(101)	(111)	(122)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	4	7	1	0	-	0	-	0	0	0
Other investing	(26)	(378)	(67)	0	-	0	-	0	0	0
<b>Investing cash flow</b>	<b>(139)</b>	<b>(555)</b>	<b>(594)</b>	<b>(84)</b>	<b>85.9</b>	<b>(92)</b>	<b>-10.0</b>	<b>(101)</b>	<b>(111)</b>	<b>(122)</b>
Equity dividends paid	(13)	(17)	(17)	(24)	-37.0	(42)	-75.2	(61)	(81)	(97)
Share issues / (buybacks)	(2)	544	721	0	-	0	-	0	0	0
Other financing	(29)	51	(390)	237	-	23	-90.20	27	36	45
Change in debt & pref shares	228	330	244	(853)	-	0	-	0	0	5
<b>Financing cash flow</b>	<b>183</b>	<b>907</b>	<b>558</b>	<b>(640)</b>	<b>-</b>	<b>(19)</b>	<b>97.1</b>	<b>(33)</b>	<b>(46)</b>	<b>(47)</b>
<b>Cash flow inc/(dec) in cash</b>	<b>22</b>	<b>364</b>	<b>(14)</b>	<b>14</b>	<b>-</b>	<b>(1)</b>	<b>-</b>	<b>252</b>	<b>271</b>	<b>310</b>
FX / non cash items	11	(1)	15	0	-99.9	0	-	0	0	(5)
<b>Balance sheet inc/(dec) in cash</b>	<b>33</b>	<b>363</b>	<b>1</b>	<b>14</b>	<b>NM</b>	<b>(1)</b>	<b>-</b>	<b>252</b>	<b>271</b>	<b>305</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## Shinva Medical Instrument (600587.SS)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	38.0	27.2	36.6	38.8	26.8	19.9	16.7	14.9
P/E (UBS, diluted)	41.1	28.8	40.3	38.8	26.8	19.9	16.7	14.9
P/CEPS	34.5	24.2	34.9	35.2	24.9	18.7	15.8	14.1
Equity FCF (UBS) yield %	(3.4)	(3.8)	(5.9)	4.9	0.1	2.1	2.4	2.7
Net dividend yield (%)	0.4	0.4	0.3	0.3	0.4	0.6	0.7	0.8
P/BV x	5.2	3.1	3.9	4.9	4.2	3.5	3.0	2.5
EV/revenues (core)	1.9	1.5	2.1	2.3	1.8	1.4	1.1	0.9
EV/EBITDA (core)	24.0	16.7	23.4	25.8	18.2	14.3	11.6	9.6
EV/EBIT (core)	27.0	18.8	25.6	27.8	19.3	15.0	12.2	10.0
EV/OpFCF (core)	NM	27.0	NM	27.8	22.2	13.1	10.8	8.9
EV/op. invested capital	6.5	4.0	4.2	5.2	5.3	4.4	3.8	3.2
<b>Enterprise value (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Market cap.	4,098	4,473	8,559	13,465	13,465	13,465	13,465	13,465
Net debt (cash)	(66)	(99)	144	(724)	(723)	(975)	(1,246)	(1,551)
Buy out of minorities	82	146	310	310	310	310	310	310
Pension provisions/other	0	0	0	0	0	0	0	0
<b>Total enterprise value</b>	<b>4,115</b>	<b>4,520</b>	<b>9,012</b>	<b>13,051</b>	<b>13,052</b>	<b>12,800</b>	<b>12,529</b>	<b>12,224</b>
Non core assets	(40)	(58)	(95)	(95)	(95)	(95)	(95)	(95)
<b>Core enterprise value</b>	<b>4,074</b>	<b>4,462</b>	<b>8,918</b>	<b>12,956</b>	<b>12,957</b>	<b>12,705</b>	<b>12,434</b>	<b>12,129</b>
<b>Growth (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Revenue	56.9	44.1	38.2	32.9	32.6	25.0	21.0	19.0
EBITDA (UBS)	72.2	57.3	43.0	31.5	42.0	24.6	20.4	18.6
EBIT (UBS)	85.1	57.7	46.8	33.5	44.5	25.5	21.0	19.0
EPS (UBS, diluted)	56.4	39.6	25.1	50.3	45.0	34.5	19.4	11.8
Net DPS	16.8	-10.6	26.2	59.5	45.0	34.5	19.4	11.8
<b>Margins &amp; Profitability (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Gross profit margin	22.8	22.8	22.9	22.6	22.8	22.8	22.8	22.8
EBITDA margin	8.1	8.8	9.1	9.0	9.6	9.6	9.6	9.5
EBIT margin	7.2	7.8	8.3	8.4	9.1	9.2	9.2	9.2
Net earnings (UBS) margin	4.7	5.1	5.0	6.2	6.8	7.3	7.2	6.8
ROIC (EBIT)	24.0	21.3	16.5	18.6	27.4	29.4	31.2	32.4
ROIC post tax	19.5	17.5	13.3	15.3	21.9	23.5	24.9	24.3
ROE (UBS)	13.3	13.6	10.8	13.5	16.9	19.3	19.3	18.3
<b>Capital structure &amp; Coverage (x)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net debt / EBITDA	(0.4)	(0.4)	0.4	(1.4)	(1.0)	(1.1)	(1.2)	(1.2)
Net debt / total equity %	(7.6)	(6.1)	5.3	(23.8)	(20.6)	(23.6)	(25.7)	(27.4)
Net debt / (net debt + total equity) %	(8.2)	(6.5)	5.0	(31.2)	(26.0)	(31.0)	(34.6)	(37.8)
Net debt/EV	(1.6)	(2.2)	1.6	(5.6)	(5.6)	(7.7)	(10.0)	(12.8)
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	5.5	6.1	12.6	1.5	1.2	1.1	1.0	0.9
EBIT / net interest	21.5	13.3	10.0	NM	NM	NM	NM	NM
Dividend cover (UBS)	5.7	8.9	8.8	8.3	8.3	8.3	8.3	8.3
Div. payout ratio (UBS) %	17.6	11.3	11.4	12.1	12.1	12.1	12.1	12.1
<b>Revenues by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	2,106	3,036	4,194	5,572	7,387	9,234	11,173	13,296
<b>Total</b>	<b>2,106</b>	<b>3,036</b>	<b>4,194</b>	<b>5,572</b>	<b>7,387</b>	<b>9,234</b>	<b>11,173</b>	<b>13,296</b>
<b>EBIT (UBS) by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	151	238	349	466	673	845	1,022	1,217
<b>Total</b>	<b>151</b>	<b>238</b>	<b>349</b>	<b>466</b>	<b>673</b>	<b>845</b>	<b>1,022</b>	<b>1,217</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

# Shanghai Fosun Pharmaceutical

## Leader in pharmaceuticals

### Diversified pharmaceutical company with strong healthcare services growth

Shanghai Fosun Pharmaceutical (Fosun) is a holding company operating across the entire pharmaceutical industry with a number of high-quality subsidiaries. It is a domestic leader in pharmaceutical production and pharmaceutical distribution. Its healthcare service business is growing rapidly and may become a major revenue/results growth driver.

### Healthcare services: accelerating; likely to be an important segment

In recent years, Fosun has been speeding up development of the healthcare service segment. Since 2011, the company has invested in five hospitals, including Foshan Chancheng Hospital. Recently, it also decided to increase its stake in United Family Hospital (UFH). We expect it to continue to develop the segment. In the next 3-5 years, it is likely to obtain controlling stakes in 10-15 hospitals with up to 15,000 beds. Revenue from healthcare services may double and could exceed Rmb1bn in 2014 and reach several billion Rmb in 2015.

### Pharma production/distribution has steady growth

Fosun's pharmaceutical production is focused on five areas: cardiovascular drugs; metabolism and digestive drugs; nervous system drugs; blood system drugs; and anti-infectives. Most core products have a leading position in their respective market segments. We expect revenue to maintain steady growth of over 20% in future. On the distribution side, the company has a 29.98% stake in Sinopharm, the largest domestic pharmaceutical distribution company. We expect the company to continue to record investment income from Sinopharm.

### Valuation: Rmb27.00 price target and Buy rating

We estimate Fosun's 2014/2015/2016 EPS at Rmb1.07/1.28/1.52. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool, assuming an 8.9% WACC.

### Equities

China  
Healthcare Providers

**12-month rating** **Buy**

**12m price target** **Rmb27.00**

**Price** **Rmb18.56**

**RIC:** 600196.SS **BBG:** 600196.CH

### Trading data and key metrics

<b>52-wk range</b>	Rmb23.67-10.97
<b>Market cap.</b>	Rmb35.4bn/US\$5.75bn
<b>Shares o/s</b>	1,904m (ORDA)
<b>Free float</b>	50%
<b>Avg. daily volume ('000)</b>	17,226
<b>Avg. daily value (m)</b>	Rmb328.8
<b>Common s/h equity (12/14E)</b>	Rmb18.1bn
<b>P/BV (12/14E)</b>	2.4x
<b>Net debt / EBITDA (12/14E)</b>	1.3x

### EPS (UBS, diluted) (Rmb)

	UBS	Cons.
<b>12/14E</b>	1.07	1.02
<b>12/15E</b>	1.28	1.21
<b>12/16E</b>	1.52	1.44

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Highlights (Rmbm)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	6,486	7,341	9,996	12,455	16,011	20,300	25,222	31,855
EBIT (UBS)	345	594	1,114	1,585	2,036	2,606	3,281	4,149
Net earnings (UBS)	1,048	1,489	1,944	2,460	2,955	3,511	4,086	4,845
EPS (UBS, diluted) (Rmb)	0.55	0.66	0.87	1.07	1.28	1.52	1.77	2.10
DPS (Rmb)	0.01	0.00	0.00	0.32	0.38	0.45	0.53	0.63
Net (debt) / cash	(2,387)	398	(2,557)	(2,878)	(3,525)	(4,075)	(4,497)	(4,915)
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	5.3	8.1	11.1	12.7	12.7	12.8	13.0	13.0
ROIC (EBIT) %	12.1	14.2	16.0	15.7	17.1	19.1	21.0	23.0
EV/EBITDA (core) x	25.9	11.8	12.0	14.2	10.9	8.7	6.9	5.4
P/E (UBS, diluted) x	19.8	15.2	15.2	17.3	14.5	12.2	10.5	8.8
Equity FCF (UBS) yield %	3.3	5.6	(0.4)	(0.5)	(0.2)	0.7	1.7	2.3
Net dividend yield %	0.1	0.0	0.0	1.7	2.1	2.5	2.9	3.4

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rmb18.56 on 15 Aug 2014 22:37 HKT

# Investment Thesis

## Fosun Pharmaceutical

### Investment case

Shanghai Fosun Pharmaceutical (Fosun) is a holding company with a number of high-quality subsidiaries in the pharmaceutical production, pharmaceutical distribution and healthcare service sectors. We expect Fosun to maintain rapid, steady growth in the next 3-5 years for the following reasons: 1) as the company speeds up its development of healthcare services, revenue from this segment is likely to double; 2) due to rapid growth of core products, we expect revenue from pharmaceutical production to maintain steady growth of over 20%; and 3) its pharmaceutical distribution business will continue to record investment income from Sinopharm. We assign the company a Buy rating.

### Upside scenario

If the company's pharmaceutical production business progresses smoothly and grows 25% YoY and healthcare services expand successfully in 2014, we estimate 2014 EPS at Rmb1.12 (5% higher than our current estimate), resulting in an upside valuation of Rmb28.00.

### Downside scenario

If the company's pharmaceutical production business grows slowly at 15% YoY and healthcare services expand more slowly than expected in 2014, we estimate a 2014 EPS at Rmb1.01 (6% lower than our estimate), resulting in a downside valuation of Rmb19.19.

### Upcoming catalysts

Continuing M&A in the field of healthcare services;

Progress in R&D of products.

12-month rating

**Buy**

12m price target

**Rmb27.00**

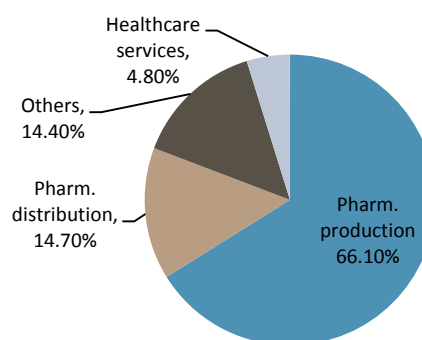
### Business description

Shanghai Fosun Pharmaceutical (Fosun) is an investment and holding company with a number of high quality subsidiaries in the pharmaceutical production, pharmaceutical distribution and healthcare service sector. For more than 10 years, Fosun has been growing rapidly both organically and via M&A, holding a controlling stake in YaoPharma, Jinzhou Aohong, and Foshan Chancheng Pharmaceuticals.

### Industry outlook

In the next five years, driven by factors such as increased health insurance coverage, an ageing population and rising healthcare needs, we expect the pharmaceutical industry to maintain steady revenue growth of around 20%.

### Revenues by segment, 2013 (%)



Source: Company data

### Gross profit by segment

Rmb m	2012	2013	2014E	2015E	2016E
Pharm. production	2,439	3,357	4,119	4,814	5,564
Pharm. distribution	217	231	254	269	286
Healthcare services	51	122	308	771	1,388
Others	507	743	890	1,065	1,255
<b>Total</b>	<b>3,214</b>	<b>4,453</b>	<b>5,571</b>	<b>6,919</b>	<b>8,493</b>

Source: Company data, UBS-S estimates

## Shanghai Fosun Pharmaceutical (600196.SS)

Income statement (Rmbm)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
<b>Revenues</b>	<b>6,486</b>	<b>7,341</b>	<b>9,996</b>	<b>12,455</b>	<b>24.6</b>	<b>16,011</b>	<b>28.5</b>	<b>20,300</b>	<b>25,222</b>	<b>31,855</b>
Gross profit	2,494	3,214	4,453	5,571	25.1	6,919	24.2	8,493	10,318	12,686
<b>EBITDA (UBS)</b>	<b>560</b>	<b>889</b>	<b>1,536</b>	<b>2,142</b>	<b>39.5</b>	<b>2,734</b>	<b>27.7</b>	<b>3,401</b>	<b>4,186</b>	<b>5,176</b>
Depreciation & amortisation	(215)	(295)	(422)	(556)	31.9	(698)	25.5	(796)	(905)	(1,027)
<b>EBIT (UBS)</b>	<b>345</b>	<b>594</b>	<b>1,114</b>	<b>1,585</b>	<b>42.3</b>	<b>2,036</b>	<b>28.4</b>	<b>2,606</b>	<b>3,281</b>	<b>4,149</b>
Associates & investment income	1,685	1,866	2,141	2,098	-2.0	2,276	8.5	2,452	2,652	2,881
Other non-operating income	(161)	(54)	(52)	0	-	0	-	0	0	0
Net interest	(290)	(370)	(384)	(252)	34.3	(223)	11.5	(181)	(223)	(233)
Exceptionals (incl goodwill)	146	87	87	0	-	0	-	0	0	0
<b>Profit before tax</b>	<b>1,727</b>	<b>2,123</b>	<b>2,906</b>	<b>3,432</b>	<b>18.1</b>	<b>4,089</b>	<b>19.2</b>	<b>4,877</b>	<b>5,710</b>	<b>6,797</b>
Tax	(342)	(284)	(506)	(524)	-3.6	(597)	-13.9	(722)	(850)	(1,024)
<b>Profit after tax</b>	<b>1,385</b>	<b>1,839</b>	<b>2,400</b>	<b>2,907</b>	<b>21.1</b>	<b>3,492</b>	<b>20.1</b>	<b>4,155</b>	<b>4,860</b>	<b>5,773</b>
Preference dividends and Minorities	(219)	(275)	(373)	(447)	-20.0	(537)	-20.0	(644)	(773)	(928)
Extraordinary items	0	0	0	0	-	0	-	0	0	0
<b>Net earnings (local GAAP)</b>	<b>1,166</b>	<b>1,564</b>	<b>2,027</b>	<b>2,460</b>	<b>21.3</b>	<b>2,955</b>	<b>20.1</b>	<b>3,511</b>	<b>4,086</b>	<b>4,845</b>
<b>Net earnings (UBS)</b>	<b>1,048</b>	<b>1,489</b>	<b>1,944</b>	<b>2,460</b>	<b>26.6</b>	<b>2,955</b>	<b>20.1</b>	<b>3,511</b>	<b>4,086</b>	<b>4,845</b>
Tax rate (%)	19.8	13.4	17.4	15.3	-12.3	14.6	-4.4	14.8	14.9	15.1
<b>Per share (Rmb)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
EPS (UBS, diluted)	0.55	0.66	0.87	1.07	23.7	1.28	19.3	1.52	1.77	2.10
EPS (local GAAP, diluted)	0.61	0.70	0.90	1.07	18.6	1.28	19.3	1.52	1.77	2.10
EPS (UBS, basic)	0.55	0.66	0.87	1.07	23.7	1.28	19.3	1.52	1.77	2.10
Net DPS (Rmb)	0.01	0.00	0.00	0.32	-	0.38	20.1	0.45	0.53	0.63
Book value per share	5.13	6.05	6.82	7.86	15.3	8.65	10.0	9.61	10.76	12.15
Average shares (diluted)	1,904.39	2,240.46	2,240.46	2,292.02	2.3	2,307.68	0.7	2,307.68	2,307.68	2,307.68
<b>Balance sheet (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Cash and equivalents	3,126	5,197	3,067	3,246	5.8	2,599	-19.9	3,149	2,626	2,709
Other current assets	2,923	3,184	3,919	4,752	21.3	5,941	25.0	7,390	9,048	11,310
<b>Total current assets</b>	<b>6,049</b>	<b>8,382</b>	<b>6,987</b>	<b>7,998</b>	<b>14.5</b>	<b>8,540</b>	<b>6.8</b>	<b>10,539</b>	<b>11,675</b>	<b>14,018</b>
Net tangible fixed assets	1,560	2,595	4,930	5,984	21.4	6,340	6.0	6,806	7,393	8,159
Net intangible fixed assets	1,683	1,753	5,615	6,195	10.3	6,739	8.8	7,249	7,725	8,166
Investments / other assets	12,998	12,778	11,886	13,194	11.0	14,396	9.1	15,750	17,256	18,937
<b>Total assets</b>	<b>22,291</b>	<b>25,507</b>	<b>29,418</b>	<b>33,371</b>	<b>13.4</b>	<b>36,016</b>	<b>7.9</b>	<b>40,344</b>	<b>44,049</b>	<b>49,281</b>
Trade payables & other ST liabilities	3,394	3,374	3,854	4,121	6.9	4,560	10.7	5,100	5,717	6,566
Short term debt	1,597	519	1,424	1,424	0.00	1,424	0.00	1,424	1,424	1,424
<b>Total current liabilities</b>	<b>4,992</b>	<b>3,893</b>	<b>5,278</b>	<b>5,545</b>	<b>5.1</b>	<b>5,984</b>	<b>7.9</b>	<b>6,525</b>	<b>7,141</b>	<b>7,990</b>
Long term debt	3,915	4,280	4,200	4,700	11.9	4,700	0.0	5,800	5,700	6,200
Other long term liabilities	2,013	2,029	2,333	2,343	0.4	2,353	0.4	2,363	2,373	2,383
Preferred shares	0	0	0	0	-	0	-	0	0	0
<b>Total liabilities (incl pref shares)</b>	<b>10,920</b>	<b>10,202</b>	<b>11,811</b>	<b>12,588</b>	<b>6.6</b>	<b>13,037</b>	<b>3.6</b>	<b>14,687</b>	<b>15,213</b>	<b>16,572</b>
Common s/h equity	9,772	13,559	15,275	18,138	18.7	19,957	10.0	22,185	24,822	28,045
Minority interests	1,599	1,746	2,332	2,646	13.4	3,021	14.2	3,472	4,014	4,663
<b>Total liabilities &amp; equity</b>	<b>22,291</b>	<b>25,507</b>	<b>29,418</b>	<b>33,371</b>	<b>13.4</b>	<b>36,016</b>	<b>7.9</b>	<b>40,344</b>	<b>44,049</b>	<b>49,281</b>
<b>Cash flow (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>% ch</b>	<b>12/15E</b>	<b>% ch</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net income (before pref divs)	1,166	1,564	2,027	2,460	21.3	2,955	20.1	3,511	4,086	4,845
Depreciation & amortisation	215	295	422	556	31.9	698	25.5	796	905	1,027
Net change in working capital	(256)	(3,431)	2,780	(556)	-	(739)	-32.8	(899)	(1,031)	(1,403)
Other operating	358	3,801	(4,293)	(1,517)	64.7	(1,660)	-9.4	(1,650)	(1,659)	(1,699)
<b>Operating cash flow</b>	<b>1,482</b>	<b>2,229</b>	<b>935</b>	<b>943</b>	<b>0.8</b>	<b>1,254</b>	<b>33.0</b>	<b>1,757</b>	<b>2,301</b>	<b>2,770</b>
Tangible capital expenditure	(797)	(1,161)	(1,040)	(1,120)	-7.7	(1,329)	-18.7	(1,501)	(1,698)	(1,963)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	1,685	1,866	2,141	(900)	-	(270)	70.0	(270)	(270)	(270)
Other investing	(2,655)	(1,684)	(2,904)	357	-	851	-	764	802	845
<b>Investing cash flow</b>	<b>(1,767)</b>	<b>(979)</b>	<b>(1,803)</b>	<b>(1,663)</b>	<b>7.8</b>	<b>(749)</b>	<b>55.0</b>	<b>(1,007)</b>	<b>(1,166)</b>	<b>(1,388)</b>
Equity dividends paid	(10)	(10)	0	(740)	-	(896)	-21.1	(1,077)	(1,281)	(1,500)
Share issues / (buybacks)	0	0	47	1,409	NM	0	-	0	0	0
Other financing	1,526	4,287	(1,753)	(270)	84.59	(255)	5.51	(224)	(275)	(299)
Change in debt & pref shares	(602)	(2,208)	773	500	-35.35	0	-	1,100	(100)	500
<b>Financing cash flow</b>	<b>913</b>	<b>2,068</b>	<b>(932)</b>	<b>898</b>	<b>-</b>	<b>(1,152)</b>	<b>-</b>	<b>(200)</b>	<b>(1,657)</b>	<b>(1,299)</b>
<b>Cash flow inc/(dec) in cash</b>	<b>629</b>	<b>3,319</b>	<b>(1,800)</b>	<b>179</b>	<b>-</b>	<b>(647)</b>	<b>-</b>	<b>550</b>	<b>(523)</b>	<b>82</b>
FX / non cash items	(1,065)	(1,248)	(330)	0	-	0	-	0	0	0
<b>Balance sheet inc/(dec) in cash</b>	<b>(436)</b>	<b>2,071</b>	<b>(2,130)</b>	<b>179</b>	<b>-</b>	<b>(647)</b>	<b>-</b>	<b>550</b>	<b>(523)</b>	<b>82</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## Shanghai Fosun Pharmaceutical (600196.SS)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	17.8	14.4	14.6	17.3	14.5	12.2	10.5	8.8
P/E (UBS, diluted)	19.8	15.2	15.2	17.3	14.5	12.2	10.5	8.8
P/CEPS	16.4	12.7	12.5	14.1	11.7	9.9	8.6	7.3
Equity FCF (UBS) yield %	3.3	5.6	(0.4)	(0.5)	(0.2)	0.7	1.7	2.3
Net dividend yield (%)	0.1	0.0	0.0	1.7	2.1	2.5	2.9	3.4
P/BV x	2.1	1.7	1.9	2.4	2.1	1.9	1.7	1.5
EV/revenues (core)	2.2	1.4	1.8	2.4	1.9	1.5	1.1	0.9
EV/EBITDA (core)	25.9	11.8	12.0	14.2	10.9	8.7	6.9	5.4
EV/EBIT (core)	NM	17.7	16.5	19.1	14.7	11.3	8.8	6.8
EV/OpFCF (core)	NM	NM	9.8	20.0	15.4	12.3	9.9	7.9
EV/op. invested capital	5.1	2.5	2.6	3.0	2.5	2.2	1.8	1.6
<b>Enterprise value (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Market cap.	20,772	19,189	25,166	35,366	35,366	35,366	35,366	35,366
Net debt (cash)	2,387	(398)	2,471	2,717	3,201	3,800	4,286	4,706
Buy out of minorities	1,599	1,746	2,332	2,646	3,021	3,472	4,014	4,663
Pension provisions/other	0	0	45	45	45	45	45	45
<b>Total enterprise value</b>	<b>24,757</b>	<b>20,537</b>	<b>30,015</b>	<b>40,774</b>	<b>41,634</b>	<b>42,683</b>	<b>43,711</b>	<b>44,781</b>
Non core assets	(10,243)	(10,047)	(11,605)	(10,461)	(11,763)	(13,217)	(14,823)	(16,604)
<b>Core enterprise value</b>	<b>14,514</b>	<b>10,490</b>	<b>18,410</b>	<b>30,313</b>	<b>29,871</b>	<b>29,467</b>	<b>28,888</b>	<b>28,177</b>
<b>Growth (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Revenue	42.4	13.2	36.2	24.6	28.5	26.8	24.2	26.3
EBITDA (UBS)	68.5	58.6	72.8	39.5	27.7	24.4	23.1	23.7
EBIT (UBS)	95.9	71.9	87.7	42.3	28.4	28.0	25.9	26.5
EPS (UBS, diluted)	29.0	20.7	30.6	23.7	19.3	18.8	16.4	18.6
Net DPS	-60.0	-15.0	-	-	20.1	18.8	16.4	18.6
<b>Margins &amp; Profitability (%)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Gross profit margin	38.5	43.8	44.5	44.7	43.2	41.8	40.9	39.8
EBITDA margin	8.6	12.1	15.4	17.2	17.1	16.8	16.6	16.2
EBIT margin	5.3	8.1	11.1	12.7	12.7	12.8	13.0	13.0
Net earnings (UBS) margin	16.2	20.3	19.4	19.7	18.5	17.3	16.2	15.2
ROIC (EBIT)	12.1	14.2	16.0	15.7	17.1	19.1	21.0	23.0
ROIC post tax	48.3	NM	4.1	12.4	13.7	15.3	16.8	18.4
ROE (UBS)	11.5	12.8	13.5	14.7	15.5	16.7	17.4	18.3
<b>Capital structure &amp; Coverage (x)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Net debt / EBITDA	4.3	(0.4)	1.7	1.3	1.3	1.2	1.1	0.9
Net debt / total equity %	21.0	(2.6)	14.5	13.8	15.3	15.9	15.6	15.0
Net debt / (net debt + total equity) %	17.3	(2.7)	12.7	12.2	13.3	13.7	13.5	13.1
Net debt/EV	16.4	(3.8)	13.9	9.5	11.8	13.8	15.6	17.4
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	12.3	15.8	10.4	9.0	8.3	7.4	6.7	6.2
EBIT / net interest	1.2	1.6	2.9	6.3	9.1	14.4	14.7	17.8
Dividend cover (UBS)	NM	NM	-	3.4	3.3	3.3	3.3	3.3
Div. payout ratio (UBS) %	1.0	0.7	-	29.7	29.9	29.9	29.9	29.9
<b>Revenues by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	6,486	7,341	9,996	12,455	16,011	20,300	25,222	31,855
<b>Total</b>	<b>6,486</b>	<b>7,341</b>	<b>9,996</b>	<b>12,455</b>	<b>16,011</b>	<b>20,300</b>	<b>25,222</b>	<b>31,855</b>
<b>EBIT (UBS) by division (Rmbm)</b>	<b>12/11</b>	<b>12/12</b>	<b>12/13</b>	<b>12/14E</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>
Others	345	594	1,114	1,585	2,036	2,606	3,281	4,149
<b>Total</b>	<b>345</b>	<b>594</b>	<b>1,114</b>	<b>1,585</b>	<b>2,036</b>	<b>2,606</b>	<b>3,281</b>	<b>4,149</b>

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

### **Statement of Risk**

We believe the major sector risks for the China healthcare sector include: 1) tightening of province-level regular bidding policies, with a visible drop in health insurance covered drug prices; 2) strict implementation of administrative measures targeting mark-ups in distribution channels, which would greatly impact agencies; and 3) weak subsidies from local finances, squeezing the basic-level healthcare market.



## Required Disclosures

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### UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	FSR is > 6% above the MRA.	48%	33%
Neutral	FSR is between -6% and 6% of the MRA.	41%	30%
Sell	FSR is > 6% below the MRA.	11%	23%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 June 2014.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Aier Eye Hospital</b>	300015.SZ	Buy	N/A	Rmb27.44	18 Aug 2014
<b>China Pioneer Pharma Holdings<sup>2, 4</sup></b>	1345.HK	Buy	N/A	HK\$5.48	18 Aug 2014
<b>CSPC Pharmaceutical Group<sup>2, 4</sup></b>	1093.HK	Buy	N/A	HK\$6.40	18 Aug 2014
<b>Guizhou Yibai Pharmaceutical</b>	600594.SS	Buy	N/A	Rmb39.83	18 Aug 2014
<b>iKang Healthcare Group<sup>2, 4, 6, 16b</sup></b>	KANG.O	Buy	N/A	US\$19.99	18 Aug 2014
<b>Jiangsu Hengrui Medicine</b>	600276.SS	Buy	N/A	Rmb34.76	18 Aug 2014
<b>Jiangsu Kanion Pharmaceutical</b>	600557.SS	Buy	N/A	Rmb28.26	18 Aug 2014
<b>Luye Pharma Group<sup>2, 4, 5</sup></b>	2186.HK	Buy	N/A	HK\$7.14	18 Aug 2014
<b>Shanghai Fosun Pharmaceutical<sup>2, 4, 5, 16a</sup></b>	600196.SS	Buy	N/A	Rmb18.81	18 Aug 2014
<b>Shanghai Kehua Bio-engineering</b>	002022.SZ	Buy	N/A	Rmb25.69	18 Aug 2014
<b>Shanghai Pharmaceuticals<sup>5</sup></b>	2607.HK	Buy	N/A	HK\$15.60	18 Aug 2014
<b>Shinva Medical Instrument</b>	600587.SS	Buy	N/A	Rmb35.55	18 Aug 2014
<b>Sihuan Pharmaceutical Holdings<sup>2, 4</sup></b>	0460.HK	Buy	N/A	HK\$4.99	18 Aug 2014
<b>Tonghua Dongbao Pharmaceutical</b>	600867.SS	Buy	N/A	Rmb13.55	18 Aug 2014
<b>Topchoice Medical Investment</b>	600763.SS	Buy	N/A	Rmb47.05	18 Aug 2014

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Additional Prices: Cachet Pharmaceutical Co., Rmb19.64 (18 Aug 2014); Shandong Dong-E E-Jiao, Rmb37.62 (18 Aug 2014); China Resources Double-Crane Pharma, Rmb18.86 (18 Aug 2014); Hunan ER-KANG Pharmaceutical, Rmb34.42 (18 Aug 2014); Hengkang Medical Group, Rmb21.97 (18 Aug 2014); Zhuhai Hokai Medical Instruments, Rmb23.76 (18 Aug 2014); Zhejiang Huahai Pharmaceutical, Rmb12.96 (18 Aug 2014); Wuhan Humanwell Healthcare, Rmb27.70 (18 Aug 2014); Jiangzhong Pharmaceutical, Rmb17.62 (18 Aug 2014); Jinling Pharmaceutical, Rmb13.20 (18 Aug 2014); Jiangsu Nhwa Pharmaceutical, Rmb24.30 (18 Aug 2014); Shangdong Realcan Pharmaceutical, Rmb32.96 (18 Aug 2014); Shenzhen Salubris Pharmaceuticals, Rmb31.20 (18 Aug 2014); Shanghai Pharmaceuticals - A, Rmb13.02 (18 Aug 2014); China National Accord Medicines, Rmb50.00 (18 Aug 2014); Tianjin Tianyao Pharmaceutical, Rmb5.03 (18 Aug 2014); Shanghai Tofflon Science and Technology, Rmb23.38 (18 Aug 2014); Guizhou Xinbang Pharmaceutical, Rmb21.96 (18 Aug 2014); Shijiazhuang Yiling Pharmaceutical, Rmb31.02 (18 Aug 2014); Jiangsu Yuyue Medical Equipment & Supply, Rmb28.75 (18 Aug 2014); Zhejiang NHU, Rmb14.91 (18 Aug 2014); Guangdong Zhongsheng Pharmaceutical Co, Rmb21.09 (18 Aug 2014); Shanghai Fosun Pharmaceutical, HK\$25.15 (18 Aug 2014); Sino Biopharmaceutical, HK\$6.95 (18 Aug 2014); Shandong Weigao Medical Polymer, HK\$7.74 (18 Aug 2014); China Medical System Holdings, HK\$10.06 (18 Aug 2014); Fu Shou Yuan International Group, HK\$4.26 (18 Aug 2014); Source: UBS. All prices as of local market close.

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