

AK Medical (1789 HK)

Solid earnings growth amid COVID-19 pandemic

AK medical reported FY20 revenue/ attributable net profit of RMB1,035mn/ RMB314mn, respectively, increasing 11.7% / 17.6% YoY, which miss consensus estimates due to COVID-19 pandemic. Gross profit margin remained largely stable at 69.0% while net profit margin improved 1.5ppts to 30.3%. Selling expense ratio decreased significantly by 4.0ppts due to decreased amount of marketing activities during COVID pandemic. Meanwhile, admin expense ratio decreased 1.9ppts and R&D expense ratio increased 1.4ppts. Maintain BUY and trimmed our DCF-based TP to HK\$12.95.

■ Resilient growth in joint implants despite impact from COVID pandemic.

Hip and knee replacement implants grew 4.9% and 12.3% YoY, respectively, accounting for 55% and 25% of total revenue. 3D-printed products grew 2.3% YoY to RMB126mn, accounting for 12% of total revenue. The Company's 3D printing products, especially the 3D-printed spinal products, are targeted mainly at Class III Level A hospitals. Such large hospitals' operations were more affected by the pandemic than lower-tier hospitals. We expect 3D printed product sales to recover in 2021E thanks to the ease of pandemic.

■ Innovative 3D printed product pipelines.

In 2020, AK medical obtained the first two registration certificates for 3D printed customized products approved by the NMPA, namely pelvis implants and customized cervical fusion which will facilitate complex customized surgeries. Besides, the Company obtained CE Full Quality Assurance System Certification for its hip and knee systems and 3D-printed interbody cage, which allows the Company to enter into the EU market. AK plans to launch 56 new products between 2021 and 2025, further enhancing its leading position in innovative orthopedic devices.

■ Impact from volume-based procurement.

In Nov 2020, the NHSA initiated the centralised procurement of coronary stents and triggered more than 90% price cuts in stents. Meanwhile, local governments, such as Jiangsu, Fujian, Zhejiang and Anhui, also carried out volume-based procurement for high-value orthopedic consumables during 2020, leading to significant price cuts ranging from 32%-86%. We think it's likely that the NHSA will conduct volume-based procurement for joint implants in 2021 and the retail price may be lowered to the current ex-factory level. We think AK could offset the price cut pressure by increasing sales proportion from high-end 3D printed products.

■ We are optimistic on AK's strong R&D capabilities.

We trimmed FY21/22E net profit forecasts by 24%/ 25% to reflect the impact from COVID-19 and the coming national-wide volume-based procurement. We derive our new TP of HK\$12.95 based on DCF model.

■ Catalysts: 1) new product launch, 2) M&A, and 3) earlier end of the COVID-19 outbreak. Risk: worse-than-expected volume-based procurement.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	927	1,035	1,217	1,535	1,978
YoY growth (%)	54.3	11.7	17.6	26.1	0.0
Net income (RMB mn)	267	314	363	475	619
EPS (RMB)	0.26	0.28	0.33	0.43	0.56
YoY growth (%)	83.8	11.0	14.2	30.9	30.3
Consensus EPS (RMB)	0.26	0.28	0.41	0.52	0.59
P/E (x)	33.7	30.4	26.6	20.3	15.6
P/B (x)	8.1	4.7	4.2	3.7	3.2
Yield (%)	1.2	1.2	1.3	1.7	2.2
ROE (%)	23.9	15.4	15.9	18.4	20.7
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$12.95
(Previous TP	HK\$17.90)
Up/Downside	+24.3%
Current Price	HK\$10.42

China Healthcare Sector

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Stock Data

Mkt Cap (HK\$ mn)	11,624
Avg 3 mths t/o (HK\$ mn)	86.20
52w High/Low (HK\$)	27.65/9.80
Total Issued Shares (mn)	1,116

Source: Bloomberg

Shareholding Structure

Management	55.24%
Hillhouse	6.9%
Free float	37.86%

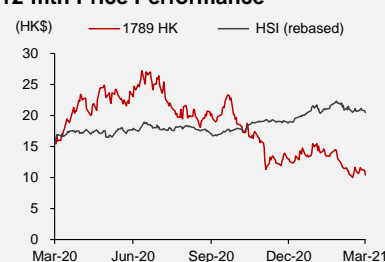
Source: HKEX

Share Performance

	Absolute	Relative
1-mth	-10.0%	-5.5%
3-mth	-14.3%	-22.5%
6-mth	-44.1%	-54.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

1. FY19 results in line; Demand remains resilient – 25 Mar 2020
2. Mild impact from COVID-19; Demand remains resilient – 12 Feb 2020
3. Results beat with enhanced visibility – 28 Aug 2019
4. Decent growth with manageable risk-7 May 2019

Figure 1: CMBIS earnings revisions

(RMB mn)	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,217	1,535	1,978	1,691	2,222	2,856	-28.0%	-30.9%	-30.7%
Gross profit	816	1,059	1,384	1,175	1,544	1,995	-30.6%	-31.4%	-30.6%
Operating profit	427	562	735	548	728	956	-22.0%	-22.8%	-23.1%
Net profit	363	475	619	479	635	832	-24.2%	-25.1%	-25.6%
EPS (RMB)	0.33	0.43	0.56	0.43	0.57	0.75	-24.9%	-25.7%	-26.2%
Gross margin	67.00%	69.00%	70.00%	69.51%	69.49%	69.86%	-2.51ppt	-0.49 ppt	+0.14 ppt
Operating margin	35.11%	36.63%	37.15%	32.41%	32.77%	33.48%	+2.70 ppt	+3.86 ppt	+3.67 ppt
Net Margin	29.82%	30.97%	31.31%	28.35%	28.57%	29.14%	+1.48 ppt	+2.41 ppt	+2.18 ppt

Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

(RMB mn)	New			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,217	1,535	1,978	1,478	1,911	2,038	-17.6%	-19.7%	-3.0%
Gross profit	816	1,059	1,384	837	908	1,278	-2.6%	16.6%	8.3%
Operating profit	427	562	735	536	655	N/A	-20.2%	-14.2%	N/A
Net profit	363	475	619	450	563	653	-19.4%	-15.6%	-5.2%
EPS (RMB)	0.33	0.43	0.56	0.41	0.52	0.59	-21.2%	-17.7%	-5.9%
Gross margin	67.00%	69.00%	70.00%	56.63%	47.53%	62.72%	+10.37ppt	+21.47 ppt	+7.28 ppt
Operating margin	35.11%	36.63%	37.15%	36.24%	34.29%	N/A	-1.13 ppt	+2.33 ppt	N/A
Net Margin	29.82%	30.97%	31.31%	30.46%	29.47%	32.04%	-0.64 ppt	+1.50 ppt	-0.73 ppt

Source: Company data, CMBIS estimates

Figure 3: Peers' valuation

Company	Ticker	Rating	Mkt cap HK\$mn	PER(x)		PBR(x)		EV/EBITDA (x)		ROE(%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
AK Medical	1789 HK	BUY	11,624	26.6	20.3	4.2	3.7	15.8	13.7	15.9	18.4
Kindly Medical	1501 HK	BUY	5,636	32.9	25.0	3.5	3.2	22.6	17.8	10.5	12.9
Chunli Medical	1858 HK	N/A	6,350	17.1	13.6	3.9	3.1	12.1	9.0	25.8	25.3
Weigao Group	1066 HK	N/A	60,509	19.5	16.5	2.5	2.2	12.8	10.6	13.6	14.6
Microport	853 HK	N/A	72,053	465.2	189.5	13.9	13.1	101.2	72.1	4.6	6.7
Lifetech	1302 HK	N/A	15,642	48.1	35.4	7.9	6.6	N/A	N/A	15.0	16.0
Venus Medtech	2500 HK	BUY	27,210	118.7	41.9	6.2	5.3	80.8	31.4	4.3	10.3
Average :				103.3	48.6	6.0	5.3	44.5	27.4	13.7	14.8

Source: Bloomberg (As at 23 Mar 2021)

Valuation

Figure 1: DCF valuation

DCF Valuation (in RMB mn)	2020	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
EBIT	369	427	562	735	904	1,094	1,301	1,523	1,751
Less: tax	(63)	(72)	(95)	(123)	(145)	(175)	(208)	(244)	(280)
Depreciation and amortisation	45	40	40	40	48	57	66	76	87
CAPEX	(100)	(100)	(100)	(100)	(120)	(142)	(166)	(189)	(217)
Change in working capital	(296)	269	(35)	(60)	(72)	(85)	(99)	(113)	(130)
FCF	(45)	564	372	492	615	749	895	1,053	1,211
Terminal value									17,736
Subtotal	(45)	564	372	492	615	749	895	1,053	18,946
% change in EBIT					23%	21%	19%	17%	15%
% change in D&A, working capital, CAPEX					20%	18%	17%	14%	15%
PV of enterprise (RMB mn)	10,806								
Net debt (RMB mn)	(1,185)								
Equity value (RMB mn)	11,991								
Equity value (HK\$ mn)	14,448								
Number of shares	1,116								
Price per share (HK\$)	12.95								
Terminal growth rate	3.0%								
WACC	10.03%								
Cost of equity	12.5%								
Cost of debt	5.0%								
Equity Beta	0.9								
Risk free rate	3.98%								
Market Risk premium	9.50%								
Target Debt to Asset ratio	30.0%								
Effective Corporate Tax Rate	16.0%								

Source: Company data, CMBIS estimates

Figure 2: Sensitivity analysis (HK\$)

Terminal growth rate	WACC						
	8.5%	9.0%	9.5%	10.0%	10.5%	11.0%	11.5%
1.5%	14.18	13.14	12.23	11.43	10.72	10.10	9.53
2.0%	14.92	13.76	12.75	11.87	11.10	10.42	9.82
2.5%	15.78	14.47	13.35	12.38	11.53	10.79	10.14
3.0%	16.80	15.30	14.03	12.95	12.02	11.21	10.49
3.5%	18.02	16.28	14.83	13.61	12.57	11.67	10.89
4.0%	19.51	17.46	15.78	14.39	13.21	12.21	11.34
4.5%	21.37	18.89	16.91	15.30	13.96	12.82	11.86

Source: Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	927	1,035	1,217	1,535	1,978	EBIT	316	369	427	562	735
Knee replacement implants	230	258	323	413	537	D&A	32	45	40	40	40
Hip replacement implants	544	571	657	821	1,051	Change in working capital	(178)	(296)	269	(35)	(60)
3D-printed products	123	126	151	205	282	Income tax paid	(33)	(49)	(72)	(95)	(123)
Third party orthopedic products	14	11	12	12	13	Others	8	137	-	-	-
Other	16	17	18	19	20	Net cash from operating	145	205	664	472	592
Cost of sales	(283)	(321)	(402)	(476)	(593)	Capex	(107)	(100)	(100)	(100)	(100)
Gross profit	643	715	816	1,059	1,384	Other	(165)	8	8	8	8
Other income and gains	20	5	5	5	5	Net cash from investing	(272)	(93)	(92)	(92)	(92)
Distribution expenses	(175)	(154)	(177)	(230)	(307)	Net proceeds equity financing	-	440	-	-	-
Administrative expenses	(92)	(83)	(95)	(118)	(150)	Dividend paid	(32)	(114)	(127)	(166)	(217)
R&D expenses	(81)	(105)	(122)	(153)	(198)	Others	10	-	-	-	-
Operating profit	316	369	427	562	735	Net cash from financing	(22)	326	(127)	(166)	(217)
Net finance income / (expenses)	6	8	8	8	8	Net change in cash	(149)	439	445	214	283
Exceptional	-	-	-	-	-	Cash at the beginning of the year	421	277	713	1,158	1,372
Pre-tax profit	321	377	435	570	743	Exchange difference	-	-	-	-	-
Profits tax	(54)	(63)	(72)	(95)	(123)	Cash at the end	277	713	1,158	1,372	1,654
Minority interest	-	-	-	-	-						
Net profit	267	314	363	475	619						

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	364	624	684	744	804	Sales mix (%)					
PP&E	284	364	434	504	574	Knee replacement implants	24.8	24.9	26.5	26.9	27.1
Intangible assets	36	76	66	56	46	Hip replacement implants	58.7	55.1	53.9	53.5	53.1
Deferred tax assets	15	51	51	51	51	3D-printed products	13.3	12.2	12.4	13.3	14.3
Other non-current asset	-	-	-	-	-	Third party orthopedic products	1.5	1.1	1.0	0.8	0.6
						Other	1.7	1.7	1.5	1.2	1.0
Current assets	1,118	1,903	2,095	2,431	2,894	Total	100.0	95.0	95.0	96.0	96.0
Inventories	229	361	308	365	455	Profit & loss ratios (%)					
Trade receivables	356	552	352	417	508	Gross margin	69.4	69.0	67.0	69.0	70.0
Deposits, prepayments & other receivables	34	34	34	34	34	Net margin	28.8	30.3	29.8	31.0	31.3
Available-for-sale financial assets	222	188	188	188	188	Effective tax rate	16.9	16.6	16.6	16.6	16.6
Cash and cash equivalents	277	713	1,158	1,372	1,654	Balance sheet ratios					
Current liabilities	328	418	434	521	642	Current ratio (x)	3.4	4.6	4.8	4.7	4.5
Payables	250	318	334	421	542	Trade receivables turnover days	75	75	75	75	75
Current tax	32	42	42	42	42	Trade payables turnover days	81	100	100	100	100
Deferred revenue	41	46	46	46	46	Inventory turnover days	255	336	280	280	280
Provision	6	-	-	-	-	Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Non-current liabilities	38	66	66	66	66	Returns (%)					
Deferred revenue	13	12	12	12	12	ROE	23.9	15.4	15.9	18.4	20.7
Deferred tax liabilities	25	39	39	39	39	ROA	18.0	12.4	13.1	15.0	16.7
Total net assets	1,116	2,043	2,279	2,588	2,990	Per share data					
Minority interest	-	-	-	-	-	EPS (RMB)	0.26	0.28	0.33	0.43	0.56
Shareholders' equity	1,116	2,043	2,279	2,588	2,990	DPS (RMB)	0.10	0.10	0.11	0.15	0.19
						BVPS (RMB)	1.1	1.9	2.0	2.3	2.7

Source: Company data, CMBIS estimates

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