

AK Medical (1789 HK)

The belated recovery will always come

AK Medical reported 2023 revenue of RMB1,093.9mn, up 4.0% YoY. Gross profit was RMB674.5mn, up 6.0% YoY. Gross profit margin improved 1.2 ppts to 61.7% thanks to effective cost control and an increased proportion of overseas revenue. Attributable net profit was RMB182.1mn, down by 11.1% YoY, and the attributable net profit margin dropped by 2.8 ppts to 16.6% in 2023 mainly due to an increase in selling expense ratio as the company expanded overseas.

- Rapid growth of overseas business offset the negative impact of domestic business decline.** Due to the decreased orthopaedic surgery volumes in China since Aug 2023, AK Medical's domestic revenue fell by 2.2% YoY to RMB866.7mn. In response to the challenging business environment in China, AK Medical proactively expanded its overseas markets under the AK and JRI brands. The AK brand has expanded to over 30 countries, partnering with approximately 45 distributors, with a primary focus on emerging markets such as Mexico and Vietnam. The JRI brand targets developed markets such as the UK, Spain and Germany. Thanks to the active exploration of overseas markets, AK Medical's overseas revenue grew by 37.1% YoY to RMB227.1mn in 2023. Sales in APAC, EMEA and Latin America exhibited significant growth, with YoY increases of 54%, 43%, and 37% respectively.
- Domestic business may recover thanks to the growing pent-up demand and the implementation of a new round of VBP.** AK Medical's domestic revenue from non-VBP products increased by approximately 30.8% YoY in 2023, accounting for 47.9% of the total domestic revenue. Notably, the domestic revenue of non-VBP products experienced remarkable growth of over 60% YoY in 1H23, indicating robust growth momentum. However, the revenue remained flat in 2H23 due to physicians' hesitancy in adopting non-VBP products during the anti-corruption campaign. As the regulatory environment gradually normalizes, we expect orthopaedic surgery volumes to resume growth in 2024E, and forecast the strong growth momentum in sales of non-VBP products to resume. Additionally, we expect the new round of VBP of joint products will start implementation in 2Q24E, which should help AK Medical to gain market share.
- Orthopedic surgical robots enter the commercialization stage.** AK Medical received its first NMPA approval for the iBot hip surgery robot in Nov 2023. Its knee surgery robot may receive approval in 2024E. Based on overseas industry dynamics, we believe robotic systems will gradually become the mainstream of orthopaedic surgery, driving the long-term growth in orthopaedic implants.
- Maintain BUY.** We think the increasing proportion of revenue from non-VBP products and overseas sales will enhance AK Medical's profitability. We expect AK Medical's revenue and attributable net profit to increase by 30.7%/48.2% YoY in 2024E. We revise our TP to HK\$7.20 based on a 9-year DCF model (WACC: 10.11%, terminal growth rate: 3.0%).

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	1,052	1,094	1,429	1,810	2,231
YoY growth (%)	38.2	4.0	30.7	26.6	23.3
Net profit (RMB mn)	205	182	270	344	430
YoY growth (%)	121.1	(11.1)	48.2	27.4	25.0
EPS (Reported) (RMB)	0.18	0.16	0.24	0.31	0.38
P/E (x)	23.7	26.8	18.2	14.3	11.4
Yield (%)	1.0	0.6	1.3	1.7	2.1
ROE (%)	9.1	7.6	10.4	12.1	13.5
Net gearing (%)	(28.0)	(11.8)	(13.6)	(14.2)	(17.2)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$7.20
(Previous TP)	HK\$8.44
Up/Downside	47.9%
Current Price	HK\$4.87

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Stock Data

Mkt Cap (HK\$ mn)	5,463.8
Avg 3 mths t/o (HK\$ mn)	18.7
52w High/Low (HK\$)	11.08/4.05
Total Issued Shares (mn)	1121.9

Source: FactSet

Shareholding Structure

Ximalaya Limited	45.3%
Gaoling Fund	6.4%

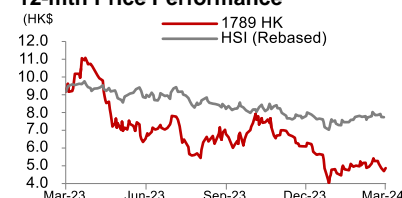
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-6.9%	-4.6%
3-mth	-20.0%	-18.9%
6-mth	-29.2%	-24.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	1,429	1,810	2,231	1,384	1,770	NA	3.3%	2.3%	NA
Gross profit	882	1,117	1,376	824	1,071	NA	7.1%	4.3%	NA
Operating profit	309	395	493	313	422	NA	-1.4%	-6.4%	NA
Net profit	270	344	430	278	372	NA	-2.8%	-7.5%	NA
EPS (RMB)	0.24	0.31	0.38	0.25	0.33	NA	-2.9%	-7.5%	NA
Gross margin	61.70%	61.70%	61.70%	59.50%	60.50%	NA	+2.20 ppt	+1.20 ppt	NA
Operating margin	21.60%	21.81%	22.10%	22.61%	23.83%	NA	-1.01 ppt	-2.03 ppt	NA
Net Margin	18.88%	18.99%	19.26%	20.06%	20.99%	NA	-1.18 ppt	-2.00 ppt	NA

Source: Company data, CMBIGM estimates

Figure 2: Risk-adjusted DCF valuation

DCF Valuation (in RMB mn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
EBIT	309	395	493	606	740	895	1,074	1,278	1,508
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	262	335	419	515	629	761	913	1,086	1,282
+ D&A	91	91	91	109	130	153	179	208	239
- Change in working capital	-73	-145	-122	-147	-175	-206	-241	-280	-322
- Capex	-150	-150	-150	-180	-214	-253	-296	-343	-394
FCFF	130	131	238	298	370	455	555	672	805
Terminal value									11,653

Terminal growth rate	3.0%
WACC	10.11%
Cost of equity	13.5%
Cost of debt	4.5%
Equity beta	1.00
Risk-free rate	3.00%
Market risk premium	10.5%
Target debt to asset ratio	35.0%
Effective corporate tax rate	15.0%

PV of enterprise value (RMB mn)	6,918
Net debt (RMB mn)	(352)
Minority interests (RMB mn)	0
Equity value (RMB mn)	7,271
Equity value (HK\$ mn)	8,079
# of shares outstanding (mn)	1,122
Price per share (HK\$)	7.20

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		9.11%	9.61%	10.11%	10.61%	11.11%
Terminal growth rate	3.5%	9.86	8.87	8.05	7.36	6.76
	3.0%	9.17	8.31	7.59	6.98	6.45
	2.5%	8.59	7.84	7.20	6.65	6.17
	2.0%	8.10	7.43	6.86	6.36	5.92
	1.5%	7.68	7.08	6.56	6.11	5.70

Source: CMBIGM estimates

Figure 4: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	1,429	1,810	2,231	1,575	2,032	2,197	-9.3%	-10.9%	1.5%
Gross profit	882	1,117	1,376	970	1,250	1,405	-9.1%	-10.6%	-2.0%
Operating profit	309	395	493	340	445	555	-9.2%	-11.2%	-11.2%
Net profit	270	344	430	354	405	437	-23.7%	-15.0%	-1.5%
EPS (RMB)	0.24	0.31	0.38	0.28	0.35	0.40	-15.0%	-12.9%	-4.2%
Gross margin	61.70%	61.70%	61.70%	61.61%	61.51%	63.94%	+0.09 ppt	+0.20 ppt	-2.24 ppt
Operating margin	21.60%	21.81%	22.10%	21.59%	21.88%	25.28%	+0.01 ppt	-0.08 ppt	-3.18 ppt
Net margin	18.88%	18.99%	19.26%	22.45%	19.91%	19.87%	-3.57 ppt	-0.92 ppt	-0.61 ppt

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	761	1,052	1,094	1,429	1,810	2,231
Cost of goods sold	(262)	(416)	(419)	(547)	(693)	(854)
Gross profit	499	636	674	882	1,117	1,376
Operating expenses	(400)	(416)	(463)	(573)	(722)	(884)
Selling expense	(187)	(180)	(219)	(300)	(378)	(464)
Admin expense	(105)	(118)	(133)	(150)	(186)	(225)
R&D expense	(113)	(111)	(137)	(143)	(177)	(214)
Others	6	(7)	26	20	20	20
Operating profit	99	220	211	309	395	493
Net Interest income/(expense)	9	20	20	9	10	13
Pre-tax profit	109	240	231	317	404	506
Income tax	(16)	(36)	(49)	(48)	(61)	(76)
After tax profit	93	205	182	270	344	430
Minority interest	0	0	0	0	0	0
Attributable net profit	93	205	182	270	344	430

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	1,934	2,065	1,975	2,159	2,415	2,741
Cash & equivalents	476	626	331	401	455	596
Account receivables	388	467	451	561	661	753
Inventories	423	402	596	600	703	796
Other current assets	648	570	597	597	597	597
Non-current assets	671	709	1,028	1,087	1,146	1,205
PP&E	382	436	575	648	722	795
Deferred income tax	76	75	67	67	67	67
Intangibles	80	85	88	74	59	45
Goodwill	132	113	113	113	113	113
Other non-current assets	0	0	185	185	185	185
Current liabilities	489	436	498	539	596	660
Short-term borrowings	0	0	21	21	21	21
Account payables	93	155	175	215	273	336
Tax payable	52	23	18	18	18	18
Other current liabilities	345	258	284	284	284	284
Non-current liabilities	84	94	113	113	113	113
Deferred income	12	13	10	10	10	10
Other non-current liabilities	72	81	103	103	103	103
Total liabilities	574	531	611	652	709	772
Share capital	9	9	10	10	10	10
Reserves	2,022	2,234	2,382	2,585	2,843	3,165
Total shareholders equity	2,032	2,244	2,392	2,594	2,852	3,174
Minority interest	0	0	0	0	0	0
Total equity and liabilities	583	540	621	661	719	782

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	109	240	231	317	404	506
Depreciation & amortization	73	79	88	91	91	91
Tax paid	(29)	(57)	(49)	(48)	(61)	(76)
Change in working capital	31	(40)	(180)	(73)	(145)	(122)
Others	(7)	22	(20)	(9)	(10)	(13)
Net cash from operations	177	243	71	279	280	386
Investing						
Capital expenditure	(76)	(122)	(233)	(150)	(150)	(150)
Net proceeds from disposal of short-term investments	(1,039)	(1,921)	(160)	0	0	0
Others	818	1,960	20	9	10	13
Net cash from investing	(297)	(82)	(373)	(141)	(140)	(137)
Financing						
Dividend paid	(37)	(24)	(46)	(67)	(86)	(107)
Net borrowings	0	0	54	0	0	0
Proceeds from share issues	0	0	0	0	0	0
Others	(64)	(13)	(15)	0	0	0
Net cash from financing	(101)	(37)	(7)	(67)	(86)	(107)
Net change in cash						
Cash at the beginning of the year	713	476	626	331	401	455
Exchange difference	(16)	26	0	0	0	0
Cash at the end of the year	476	626	316	401	455	596
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	(26.5%)	38.2%	4.0%	30.7%	26.6%	23.3%
Gross profit	(30.1%)	27.5%	6.0%	30.7%	26.6%	23.3%
Operating profit	(73.0%)	121.2%	(3.9%)	46.0%	27.8%	24.9%
Net profit	(70.5%)	121.1%	(11.1%)	48.2%	27.4%	25.0%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	65.6%	60.5%	61.7%	61.7%	61.7%	61.7%
Operating margin	13.1%	20.9%	19.3%	21.6%	21.8%	22.1%
Return on equity (ROE)	4.5%	9.6%	7.9%	10.8%	12.6%	14.3%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.3)	(0.3)	(0.1)	(0.1)	(0.1)	(0.2)
Current ratio (x)	4.0	4.7	4.0	4.0	4.1	4.2
Receivable turnover days	201.0	148.3	153.2	143.2	133.2	123.2
Inventory turnover days	545.4	362.4	434.2	400.0	370.0	340.0
Payable turnover days	166.0	108.9	143.6	143.6	143.6	143.6
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	52.7	23.7	26.8	18.2	14.3	11.4
Div yield (%)	0.2	1.0	0.6	1.3	1.7	2.1
EV/EBITDA	25.0	14.2	15.3	11.3	9.2	7.4
EV/Sales	5.7	4.0	4.2	3.2	2.5	1.9

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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