

AK Medical (1789 HK)

FY19 results in line; Demand remains resilient

We maintain our previous revenue forecasts unchanged and slightly raised FY20/21E net profit forecasts by 2.8%/ 4.6% to reflect the margin expansion. As the orthopedic surgery demand is resilient, we expect mild impact from COVID-19 outbreak. Maintain BUY and lifted our DCF-based TP to HK\$17.9.

- FY19 results in line.** FY19 revenue / net profit grew 54.3% / 84.2% YoY to RMB927mn/ RMB267mn, which was 1.4% / 1.1% above our forecasts. GPM improved by 1.3ppt to 69.4% thanks to faster growth in high-margin products. Other income increased from RMB5mn in FY18 to RMB20m in FY19, mainly due to a one-off insurance compensation from JIR. Marketing and admin expense ratio dropped by around 2ppt due to economies of scale. NPM climbed by 4.7ppt to 28.8% in FY19.
- Strong growth of joint implant and 3D-printed product.** By products, 3D-printed products grew 76.5% YoY to RMB123mn, due to 1) continuous academic marketing activities, 2) new product launches, 3) adoption by more hospitals and 3D ACT platform increased coverage to 964 hospitals. Hip implants grew 54.7% YoY to RMB544mn, of which hip volume increased by 39.9% YoY and knee implants grew 58.3% YoY to RMB230mn, which were attributable to 1) the 3D-printing technology and the implementation of the international clinical education resources, 2) new product launches with higher selling price, and 3) penetration into more hospitals.
- Moderate impact from COVID-19.** Orthopedic surgery volume shrank in 1Q20 due to COVID-19 outbreak. However, hospitals resume surgeries gradually since early Mar. In our view, orthopedic surgery demand is delayed instead of disappeared. AK has fully resumed production in China and total capacity will exceed 250,000 sets in 2020E. In our view, AK's sales will catch up from 2Q20E and achieve its full-year revenue growth target of 30% in 2020E.
- Abundant cash for M&A.** As of 31 Dec 2019, AK had cash and cash equivalents of RMB499mn on hand. Those, together with recent placement of HK\$783mn, amounted to over RMB1bn, which are sufficient for sizeable acquisitions. We believe AK will seek targets in the spine and trauma fields, and orthopedic products with new technology and new material.
- Maintain BUY; Lifted TP to HK\$17.90.** We are optimistic on AK's long-term prospects. We raised FY20/21E net profit forecasts by 2.8%/ 4.6% to reflect margin expansion resulted from economies of scale. We derive our new TP of HK\$17.90 based on DCF model.
- Catalysts:** 1) new product launch, 2) M&A, and 3) earlier end of the COVID-19 outbreak.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	601	927	1,234	1,691	2,222
YoY growth (%)	61.1	54.3	33.2	37.0	31.5
Net income (RMB mn)	145	267	347	479	637
EPS (RMB)	0.14	0.26	0.31	0.43	0.57
YoY growth (%)	0.6	83.8	22.2	38.1	32.5
Consensus EPS (RMB)	0.14	0.26	0.30	0.40	0.53
P/E (x)	99.1	53.9	44.1	31.9	24.1
P/B (x)	17.1	12.9	7.2	6.2	5.2
Yield (%)	0.4	0.6	0.7	0.9	1.2
ROE (%)	17.2	23.9	16.4	19.4	21.6
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$17.90
(Previous TP)	HK\$16.50)
Up/Downside	+16.1%
Current Price	HK\$15.42

China Healthcare Sector

Amy Ge
 (852) 3761 8778
 amyge@cmbi.com.hk

Jill Wu, CFA
 (852) 3900 0842
 jillwu@cmbi.com.hk

Sam HU, PhD
 Tel: (852) 3900 0882
 samhu@cmbi.com.hk

Stock Data	
Mkt Cap (HK\$ mn)	17,058
Avg 3 mths t/o (HK\$ mn)	31.56
52w High/Low (HK\$)	18/3.39
Total Issued Shares (mn)	1,106
Source: Bloomberg	

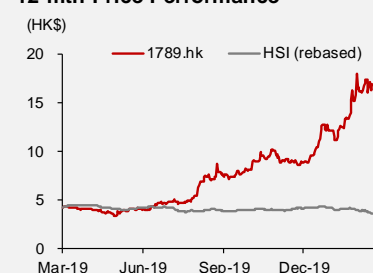
Shareholding Structure

Management	55.24%
Hillhouse	6.9%
Free float	37.86%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	-1.9%	-15.5%
3-mth	74.2%	-18.7%
6-mth	98.5%	-13.8%
Source: Bloomberg		

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

- Mild impact from COVID-19; Demand remains resilient – 12 Feb 2020
- Results beat with enhanced visibility – 28 Aug 2019
- Decent growth with manageable risk-7 May 2019

Figure 1: FY19A results change

(RMB mn)	1H18	1H19	YoY Change	2018	2019	YoY Change	CMBIS 2019E	Diff (%)
Knee replacement implants	73	111	52.1%	145	230	58.3%	218	5.6%
Hip replacement implants	162	256	57.3%	352	544	54.7%	530	2.7%
3D-printed products	27	51	88.2%	70	123	76.5%	126	-2.0%
Third party orthopedic products	6	7	20.0%	12	14	14.5%	14	-4.6%
Other	6	13	102.0%	22	16	-28.4%	26	-40.3%
Total revenue	275	438	59.2%	601	927	54.3%	914	1.4%
COGS	-84	-133	58.2%	-192	-283	47.9%	-270	4.8%
Gross profit	191	305	59.6%	409	643	57.3%	644	0.0%
Other income	0	16	3360.1%	5	20	311.4%	20	2.0%
Distribution expenses	-50	-84	68.2%	-123	-175	42.7%	-165	6.6%
Administrative expenses	-36	-48	33.5%	-74	-92	24.4%	-109	-15.1%
R&D expenses	-20	-35	79.6%	-46	-81	76.6%	-82	-2.1%
Operating profit	86	153	78.2%	171	316	84.3%	308	2.4%
Net finance costs	2	3	64.7%	3	6	79.7%	10	-42.1%
Profit before tax	88	156	77.9%	175	321	84.2%	318	1.0%
Income tax	-17	-27	62.4%	-30	-54	84.0%	-54	0.6%
Minority interest	0	0	N/A	0	0	N/A	0	N/A
Net profit	71	130	81.5%	145	267	84.2%	264	1.1%

Source: Company data, CMBIS estimates

Figure 2: CMBI earnings revisions

(RMB mn)	New		Old		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	1,234	1,691	1,236	1,691	-0.1%	0.0%
Gross profit	862	1,175	863	1,175	-0.1%	0.0%
Operating profit	402	548	388	528	3.5%	3.8%
Net profit	347	479	338	458	2.8%	4.6%
EPS (RMB)	0.31	0.43	0.33	0.44	-3.6%	-1.9%
Gross margin	69.85%	69.51%	69.85%	69.53%	-0.01ppt	-0.02 ppt
Operating margin	32.54%	32.41%	31.42%	31.23%	+1.12 ppt	+1.18 ppt
Net Margin	28.10%	28.35%	27.32%	27.11%	+0.78 ppt	+1.24 ppt

Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

(RMB mn)	CMBI		Consensus		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	1,234	1,691	1251	1714	-1.4%	-1.3%
Gross profit	862	1,175	868	1188	-0.7%	-1.1%
Operating profit	402	548	388	528	3.6%	3.8%
Net profit	347	479	335	461	3.5%	4.0%
EPS (RMB)	0.31	0.43	0.30	0.40	3.3%	6.4%
Gross margin	69.85%	69.51%	69.4%	69.3%	+0.48ppt	+0.18ppt
Operating margin	32.54%	32.41%	31.0%	30.8%	+1.52ppt	+1.6ppt
Net Margin	28.10%	28.35%	26.8%	26.9%	+1.29ppt	+1.48ppt

Source: Company data, CMBIS estimates

Figure 4: Peers' valuation

Company	Ticker	Rating	Mkt cap HK\$mn	PER(x)		PBR(x)		EV/EBITDA (x)		ROE(%)	
				FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
AK Medical	1789 HK	BUY	17,058	44.1	31.9	7.2	6.2	36.7	26.7	16.4	19.4
Kindly Medical	1501 HK	BUY	6,134	36.1	27.6	3.7	3.4	10.0	7.3	10.1	12.8
Chunli Medical	1858 HK	N/A	11,607	30.1	NA	8.2	NA	30.6	24.4	35.1	28.3
Weigao Group	1066 HK	N/A	41,198	16.6	14.2	2.1	1.8	11.7	10.2	12.9	13.3
Microport	853 HK	N/A	27,615	73.7	55.8	6.2	5.7	39.3	32.8	9.6	11.6
Lifetech	1302 HK	N/A	7,518	33.7	29.4	5.3	4.0	27.8	22.9	14.8	15.3
Venus Medtech	2500 HK	BUY	16,805	N/A	46.8	5.7	5.0	243.5	42.0	2.8	9.3
			Average	39.2	34.4	5.4	4.4	57.1	23.8	14.5	15.7

Source: CMBIS estimates, Bloomberg (As at 24 Mar 2020)

Valuation

Figure 5: DCF valuation

DCF Valuation (in RMB mn)	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
EBIT	402	548	728	956	1,147	1,354	1,584	1,806	2,077
Less: tax	(71)	(98)	(129)	(170)	(184)	(217)	(253)	(289)	(332)
Depreciation and amortisation	46	57	62	66	79	93	109	124	143
CAPEX	(100)	(50)	(30)	(30)	(36)	(42)	(50)	(57)	(65)
Change in working capital	85	(87)	(78)	(103)	(124)	(146)	(171)	(195)	(224)
FCF	362	370	553	719	883	1,042	1,219	1,390	1,598
Terminal value									27,432
Subtotal	362	370	553	719	883	1,042	1,219	1,390	29,030
% change in EBIT					20%	18%	17%	14%	15%
% change in D&A, working capital, CAPEX					20%	18%	17%	14%	15%
Present value of enterprise (RMB mn)	16,194								
Debt & Preferred Stock	0								
Bank deposit and pledged cash	1,534								
Equity Value	17,728								
Number of shares	1,106								
Value per share (Rmb)	16.03								
Value per share (HK\$)	17.90								
Risk free rate	4.0%								
Beta	0.90								
Risk premium	9.1%								
Cost of equity	12.2%								
Cost of debt	6.0%								
WACC	10.1%								
Terminal growth rate	4.0%								

Source: Company data, CMBIS estimates

Figure 6: Sensitivity analysis (HK\$)

Terminal growth rate	WACC						
	8.6%	9.1%	9.6%	10.1%	10.6%	11.1%	11.6%
2.5%	19.60	18.00	16.60	15.40	14.40	13.50	12.70
3.0%	20.80	19.00	17.40	16.10	15.00	14.00	13.10
3.5%	22.30	20.20	18.40	16.90	15.60	14.50	13.60
4.0%	24.10	21.60	19.60	17.90	16.40	15.20	14.10
4.5%	26.40	23.40	20.90	19.00	17.30	16.00	14.80
5.0%	29.30	25.50	22.60	20.30	18.40	16.80	15.50
5.5%	33.10	28.30	24.70	21.90	19.70	17.90	16.30

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	601	927	1,234	1,691	2,222
Knee replacement implants	145	230	299	403	525
Hip replacement implants	352	544	700	930	1,169
3D-printed products	70	123	202	319	484
Third party orthopedic products	12	14	16	18	21
Other	22	16	18	21	24
Cost of sales	(192)	(283)	(372)	(516)	(678)
Gross profit	409	643	862	1,175	1,544
Other income and gains	5	20	6	6	6
Distribution expenses	(123)	(175)	(234)	(320)	(420)
Administrative expenses	(74)	(92)	(125)	(166)	(208)
R&D expenses	(46)	(81)	(107)	(147)	(193)
Operating profit	171	316	402	548	728
Net finance income / (expenses)	3	6	16	29	36
Exceptional	-	-	-	-	1
Pre-tax profit	175	321	418	577	765
Profits tax	(30)	(54)	(71)	(98)	(129)
Minority interest	-	-	-	-	1
Net profit	145	267	347	479	637

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
EBIT	171	316	402	548	728
D&A	21	27	46	57	62
Change in working capital	(42)	(128)	85	(87)	(78)
Income tax paid	(24)	(43)	(71)	(98)	(129)
Others	2	-	0	(0)	-
Net cash from operating	128	171	462	420	583
Capex	(197)	(143)	(100)	(50)	(30)
Other	(26)	(101)	16	29	36
Net cash from investing	(224)	(244)	(84)	(21)	6
Net proceeds equity financing	53	-	783	-	-
Dividend paid	(32)	(72)	(126)	(124)	(167)
Others	(25)	-	-	-	-
Net cash from financing	(4)	(72)	657	(124)	(167)
Net change in cash	(100)	(145)	1,03	276	422
Cash at the beginning of the year	517	421	277	1,311	1,587
Exchange difference	3	-	-	-	-
Cash at the end	421	277	1,311	1,587	2,009

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	268	364	418	411	378
PP&E	166	284	346	346	321
Intangible assets	38	36	28	20	13
Deferred tax assets	13	15	15	15	15
Other non-current asset	51	29	29	29	29
Current assets	825	1,118	2,182	2,657	3,308
Inventories	166	229	255	354	465
Trade receivables	184	356	358	460	578
Deposits, prepayments & other receivables	18	34	34	34	34
Available-for-sale financial assets	36	222	222	222	222
Cash and cash equivalents	421	277	1,311	1,587	2,009
Current liabilities	228	328	442	554	706
Payables	160	250	363	476	627
Current tax	15	32	32	32	32
Deferred revenue	53	41	41	41	41
Provision	1	6	6	6	6
Non-current liabilities	23	38	38	38	38
Deferred revenue	11	13	13	13	13
Deferred tax liabilities	12	25	25	25	25
Total net assets	842	1,116	2,120	2,475	2,943
Minority interest	-	-	-	-	-
Shareholders' equity	842	1,116	2,120	2,475	2,943

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Knee replacement implants	24.2	24.8	24.2	23.8	23.6
Hip replacement implants	58.6	58.7	56.7	55.0	52.6
3D-printed products	11.6	13.3	16.4	18.9	21.8
Third party orthopedic products	2.0	1.5	1.3	1.1	0.9
Other	3.6	1.7	1.4	1.2	1.1
Total	100.	100.	100.	100.	100.
Profit & loss ratios (%)					
Gross margin	68.1	69.4	69.8	69.5	69.5
Net margin	24.1	28.8	28.1	28.3	28.7
Effective tax rate	16.9	16.9	16.9	16.9	16.9
Balance sheet ratios					
Current ratio (x)	3.6	3.4	4.9	4.8	4.7
Trade receivables turnover days	75	80	80	80	80
Trade payables turnover days	91	91	91	91	91
Inventory turnover days	241	247	247	247	247
Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	17.2	23.9	16.4	19.4	21.6
ROA	13.3	18.0	13.3	15.6	17.3
Per share data					
EPS (RMB)	0.14	0.26	0.31	0.43	0.57
DPS (RMB)	0.06	0.08	0.09	0.13	0.17
BVPS (RMB)	0.8	1.1	1.9	2.2	2.7

Source: Company data, CMBIS estimates

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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