

AK Medical (1789 HK)

2023 guidance cut, expecting recovery in 2024

AK Medical cut its FY23 sales and net profit guidance, primarily due to the declined orthopaedic surgery volumes amid the challenging business environment in China. The Company now expects 2023E revenue to remain flat, down from its previous guidance of 30% YoY revenue growth for 2023E. NPM may slightly drop because the anti-corruption activities hurt the sales of high-margin non-VBP products in 2H23. AK medical expects the business to recover in 2024E and forecasts at least 30% YoY revenue growth and above 20% NPM in 2024E.

■ **High-margin non-VBP products have been disproportionately affected since Aug with slight turnaround of surgery volumes in Oct.** In 1H23, 48% of AK Medical's domestic revenue was from the high-margin non-VBP products such as revision and reconstruction joints, 3D-printed spinal implants, partial knee products and customized products (ICOS), etc. However, the management noted that clinicians preferred to use VBP products rather than the non-VBP products since Aug due to the anti-corruption campaign. Thus, the Company's revenue and NPM were both negatively impacted from 3Q23. AK Medical has seen slight recovery of surgery volumes in Oct as it was flat YoY compared to a 10% YoY drop in Sep. Academic conferences have gradually resumed while the marketing events led by the Company are still suspended. AK Medical expects surgery volumes to be back on track after the Spring Festival.

■ **Expect moderate price recovery in the upcoming VBP renewal.** AK Medical believes the joint VBP renewal will be initiated by the end of the year and be implemented in 2Q24E. We expect the VBP renewal of joints to follow the rules of coronary stents and trauma products which led to the convergence of the bidding prices. AK Medical has relatively low bidding prices in the previous VBP with hip joint price of ~ RMB5,900/unit (vs. average price of ~ RMB7,000/unit), and knee joint price of ~ RMB 3,400/unit (vs. average price of ~ RMB5,000/unit). AK Medical lose market share in hip joints because distributors received less margins from AK Medical than other domestic brands and were less motivated to promote AK's products. We expect AK Medical's bidding prices to increase during the VBP renewal, which will allow the Company to offer higher margins to its distributors while maintain relatively stable out-of-factory prices. Therefore, we believe AK Medical will regain market share in the hip joint market in 2024E, leveraging its high product quality and wide distribution network.

■ **Maintain BUY.** To factor in the lower-than-expected sales in 2023E and our expectation on the surgery volume recovery in 2024E, we revised our TP to HK\$8.44 based on a 9-year DCF model (WACC: 11.08%, terminal growth rate: 2.5%), implying 31x 24E P/E.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	761	1,052	1,058	1,384	1,770
YoY growth (%)	(26.5)	38.2	0.6	30.8	27.9
Net profit (RMB mn)	92.6	204.8	198.1	277.7	371.5
YoY growth (%)	(70.5)	121.1	(3.3)	40.2	33.8
EPS (Reported) (RMB)	0.08	0.18	0.18	0.25	0.33
YoY growth (%)	(70.8)	121.8	(4.3)	40.2	33.8
P/E (x)	77.7	35.1	36.6	26.1	19.5
Yield (%)	0.3	0.8	0.7	1.0	1.3
ROE (%)	4.6	9.1	8.3	10.7	12.9
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$8.44**
 (Previous TP) HK\$8.46
Up/Downside **17.4%**
Current Price **HK\$7.19**

China Healthcare

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

Cathy WANG
 (852) 3916 1729
 cathywang@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn) 8,061.6
 Avg 3 mths t/o (HK\$ mn) 25.8
 52w High/Low (HK\$) 11.08/5.44
 Total Issued Shares (mn) 1121.2
 Source: FactSet

Shareholding Structure

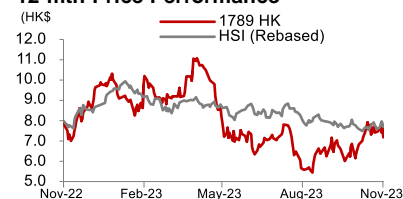
Ximalaya Limited 45.3%
 Gaoling Fund 6.4%
 Source: HKEx

Share Performance

	Absolute	Relative
1-mth	11.8%	13.9%
3-mth	27.3%	33.6%
6-mth	-9.2%	1.7%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,058	1,384	1,770	1,368	1,777	2,315	-22.6%	-22.1%	-23.6%
Gross profit	614	824	1,071	834	1,088	1,422	-26.5%	-24.3%	-24.7%
Operating profit	220	313	422	305	392	516	-28.1%	-20.1%	-18.2%
Net profit	198	278	372	269	342	449	-26.3%	-18.9%	-17.2%
EPS (RMB)	0.18	0.25	0.33	0.24	0.31	0.40	-26.3%	-18.9%	-17.2%
Gross margin	58.00%	59.50%	60.50%	61.00%	61.20%	61.40%	-3.00 ppt	-1.70 ppt	-0.90 ppt
Operating margin	20.76%	22.61%	23.83%	22.32%	22.03%	22.28%	-1.56 ppt	+0.58 ppt	+1.55 ppt
Net Margin	18.72%	20.06%	20.99%	19.64%	19.26%	19.39%	-0.92 ppt	+0.80 ppt	+1.60 ppt

Source: Company data, CMBIGM estimates

Figure 2: Risk-adjusted DCF valuation

DCF Valuation (in RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
EBIT	220	313	422	527	654	804	981	1,187	1,425
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	187	266	359	448	556	684	834	1,009	1,211
+ D&A	80	80	80	96	115	135	159	184	211
- Change in working capital	-13	-157	-168	-201	-239	-283	-331	-383	-441
- Capex	-115	-115	-115	-138	-164	-194	-227	-263	-302
CCFF	139	74	156	205	267	343	435	547	679
Terminal value									8,116
FCF + Terminal value	139	74	156	205	267	343	435	547	8,795

Terminal growth rate	2.5%
WACC	11.08%
Cost of Equity	14.0%
Cost of Debt	5.0%
Equity Beta	1.10
Risk Free Rate	3.00%
Market Risk Premium	10.0%
Target Debt to Asset ratio	30.0%
Effective Corporate Tax Rate	15.0%

PV of enterprise value (RMB mn)	7,791
Net debt (RMB mn)	(729)
Minority interests (RMB mn)	0
Equity value (RMB mn)	8,520
Equity value (HK\$ mn)	9,466
# of shares outstanding (mn)	1,121
Price per share (HK\$)	8.44

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		10.08%	10.58%	11.08%	11.58%	12.08%
Terminal growth rate	3.5%	11.20	10.20	9.34	8.59	7.94
	3.0%	10.53	9.64	8.86	8.19	7.59
	2.5%	9.95	9.14	8.44	7.83	7.28
	2.0%	9.44	8.71	8.07	7.50	7.00
	1.5%	8.99	8.32	7.74	7.21	6.75

Figure 4: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,058	1,384	1,770	1,370	1,787	2,293	-22.8%	-22.5%	-22.8%
Gross Profit	614	824	1,071	841	1,101	1,417	-27.0%	-25.2%	-24.4%
Operating Profit	220	313	422	301	396	503	-27.0%	-20.9%	-16.1%
Net profit	198	278	372	267	350	446	-25.7%	-20.6%	-16.6%
EPS (RMB)	0.18	0.25	0.33	0.24	0.31	0.41	-25.5%	-20.9%	-18.4%
Gross Margin	58.00%	59.50%	60.50%	61.37%	61.59%	61.79%	-3.37 ppt	-2.09 ppt	-1.29 ppt
Operating Margin	20.76%	22.61%	23.83%	21.96%	22.13%	21.93%	-1.20 ppt	+0.48 ppt	+1.90 ppt
Net Margin	18.72%	20.06%	20.99%	19.47%	19.58%	19.43%	-0.75 ppt	+0.48 ppt	+1.56 ppt

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	1,035	761	1,052	1,058	1,384	1,770
Cost of goods sold	(321)	(262)	(416)	(444)	(561)	(699)
Gross profit	715	499	636	614	824	1,071
Operating expenses	(346)	(400)	(416)	(394)	(511)	(649)
Selling expense	(154)	(187)	(180)	(178)	(235)	(301)
Admin expense	(83)	(105)	(118)	(116)	(145)	(182)
R&D expense	(105)	(113)	(111)	(111)	(141)	(177)
Others	(4)	6	(7)	11	11	11
Operating profit	369	99	220	220	313	422
Net Interest income/(expense)	8	9	20	13	14	15
Pre-tax profit	377	109	240	233	327	437
Income tax	(63)	(16)	(36)	(35)	(49)	(66)
Net profit	314	93	205	198	278	372
Minority interest	0	0	0	0	0	0
Net profit attributable to shareholders	314	93	205	198	278	372

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	1,903	1,934	2,065	2,158	2,367	2,653
Cash & equivalents	713	476	626	727	744	820
Account receivables	451	388	467	435	531	630
Inventories	361	423	402	426	522	632
Other current assets	378	648	570	570	570	570
Non-current assets	624	671	709	744	778	813
PP&E	364	382	436	482	529	576
Deferred income tax	51	76	75	75	75	75
Intangibles	76	80	85	73	61	49
Goodwill	133	132	113	113	113	113
Other non-current assets	0	0	0	0	0	0
Current liabilities	418	489	436	415	450	492
Short-term borrowings	0	0	0	0	0	0
Account payables	146	93	155	134	169	211
Tax payable	42	52	23	23	23	23
Other current liabilities	230	345	258	258	258	258
Non-current liabilities	66	84	94	94	94	94
Deferred income	12	12	13	13	13	13
Other non-current liabilities	54	72	81	81	81	81
Total liabilities	484	574	531	509	545	586
Share capital	9	9	9	9	9	9
Other reserves	2,033	2,022	2,234	2,383	2,591	2,870
Minority interest	0	0	0	0	0	0
Total shareholders equity	2,043	2,032	2,244	2,392	2,601	2,879
Total equity and liabilities	494	583	540	519	554	596

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	377	109	240	233	327	437
Depreciation & amortization	58	73	79	80	80	80
Tax paid	(45)	(29)	(57)	(35)	(49)	(66)
Change in working capital	(186)	31	(40)	(13)	(157)	(168)
Others	1	(7)	22	(13)	(14)	(15)
Net cash from operations	205	177	243	252	187	269
Investing						
Capital expenditure	(351)	(76)	(122)	(115)	(115)	(115)
Net proceeds from disposal of short-term investments	(548)	(1,039)	(1,921)	0	0	0
Others	542	818	1,960	13	14	15
Net cash from investing	(356)	(297)	(82)	(102)	(101)	(100)
Financing						
Dividend paid	(75)	(37)	(24)	(50)	(69)	(93)
Net borrowings	(2)	0	0	0	0	0
Proceeds from share issues	701	0	0	0	0	0
Others	(13)	(64)	(13)	0	0	0
Net cash from financing	612	(101)	(37)	(50)	(69)	(93)
Net change in cash						
Cash at the beginning of the year	277	713	476	626	727	744
Exchange difference	(24)	(16)	26	0	0	0
Cash at the end of the year	713	476	626	727	744	820
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	11.7%	(26.5%)	38.2%	0.6%	30.8%	27.9%
Gross profit	11.1%	(30.1%)	27.5%	(3.6%)	34.2%	30.0%
Operating profit	16.9%	(73.0%)	121.2%	(0.2%)	42.5%	34.8%
Net profit	17.6%	(70.5%)	121.1%	(3.3%)	40.2%	33.8%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	69.0%	65.6%	60.5%	58.0%	59.5%	60.5%
Operating margin	35.6%	13.1%	20.9%	20.8%	22.6%	23.8%
Return on equity (ROE)	15.4%	4.6%	9.1%	8.3%	10.7%	12.9%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)
Current ratio (x)	4.6	4.0	4.7	5.2	5.3	5.4
Receivable turnover days	127.3	201.0	148.3	150.0	140.0	130.0
Inventory turnover days	335.6	545.4	362.4	350.0	340.0	330.0
Payable turnover days	127.8	166.0	108.9	110.0	110.0	110.0
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	22.7	77.7	35.1	36.6	26.1	19.5
Div yield (%)	0.5	0.3	0.8	0.7	1.0	1.3
EV/EBITDA	15.1	38.5	21.9	21.5	16.4	12.7
EV/EBIT	17.4	66.7	29.8	29.4	20.6	15.1
EV/Sales	6.2	8.7	6.2	6.1	4.6	3.6

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

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

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

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.