

AK Medical (1789 HK)

Results beat with enhanced visibility

AK recorded encouraging 1H19 results. 1H19 revenue/ net profit reached our previous forecasts of 54.5%/ 68.2%. We raised our FY19/20E revenue forecasts by 10.1%/ 15.1%. We expect AK Medical to deliver 37.9% CAGR in FY18-21E. Key growth driver is the import substitution in the joint implant industry. Besides, given that policies on drug bulk procurement have been eased, we believe procurement policies of high-value device may also soften. We raise our 12-month target price to HK\$7.20, with 15% upside potential. Maintain BUY.

- **Forecast-beating 1H19 results.** 1H19 revenue was RMB438mn, up 59.2% YoY, driven by strong off-the-shelf implants and solid 3D-printed products. 1H19 net profit was RMB153mn, up 81.5% YoY and adjusted net profit (excluding one-off item) was RMB114mn, up 60.7% YoY. 1H19 revenue and net profit reached our full-year forecasts of 54.5%/ 68.2%, beating our estimates.
- **Stronger-than-expected off-the-shelf implants and 3D-printed products.** Knee implants grew 52%, hip implants grew 57% and 3D-printed products grew 88.2% in 1H19 driven by enhanced academic marketing activities. AK strengthened internal sales management in 1H19 and also held more marketing events such as international roadshows, discovery tours of artificial joints and face to face interaction with masters, etc. Hospitals covered increased to over 5,300 in 1H19. We believe AK will continue to gain market share onwards from MNCs given 1) comprehensive joint product line, and 2) current favorable policies to domestic brands. 2018 joint implant market share of MNC/ domestic brand was 55%/ 45% by volume and 70%/ 30% by sales, and import substitution is still underway in this niche market.
- **Device procurement policy may soften.** We see that Nanjing and Anhui have already implemented volume-based device procurement in a few selected varieties. In our view, device procurement execution may vary from province to province. Besides, given that policies on drug bulk procurement has been eased, we believe device procurement may also soften.
- **Maintain BUY with new TP of HK\$7.20.** We raise FY19E/20E revenue forecasts by 10.1%/ 15.1% to reflect stronger off-the-shelf implants. We raise selling expenses due to more academic marketing activities onwards. We lift FY19/20E net profit by 22%/ 15%. We derive our new TP of HK\$7.20 based on DCF model. AK currently trades at 25x/ 20 FY19E/20E P/E. **Catalysts:** 1) launch of custom designed 3D-printed products, and 2) M&As.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	373	601	884	1,206	1,576
YoY growth (%)	37.6	61.1	47.3	36.4	30.6
Net income (RMB mn)	105	145	231	291	375
EPS (RMB)	0.14	0.14	0.22	0.28	0.36
YoY growth (%)	34.7	0.6	59.3	26.2	28.8
P/E (x)	40.6	40.4	25.4	20.1	15.6
P/B (x)	6.4	7.0	5.8	4.8	3.9
Yield (%)	1.7	1.1	1.2	1.5	1.9
ROE (%)	15.8	17.2	23.0	23.9	25.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	HK\$7.20
(Previous TP	HK\$6.50)
Up/Downside	+15%
Current Price	HK\$6.29

China Healthcare Sector

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Stock Data

Mkt Cap (HK\$ mn)	6,566
Avg 3 mths t/o (HK\$ mn)	7.16
52w High/Low (HK\$)	6.44/3.41
Total Issued Shares (mn)	1,044

Source: Bloomberg

Shareholding Structure

Management	62.57%
OrbiMed Asia	7.21%
Free float	30.22%

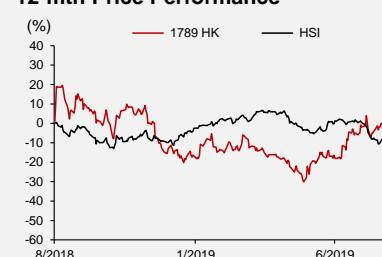
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	12.9%	24.9%
3-mth	58.5%	68.8%
6-mth	29.7%	45.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

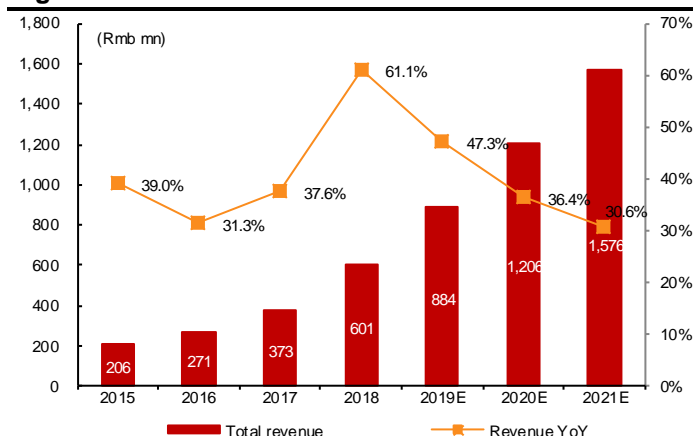
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Related Reports

- Decent growth with manageable risk- 7 May 2019
- Solid fundamental; positive on long-term growth – 21 Jan 2019;
- Leading orthopedic joint manufacturer with novel 3D-printed technology – 16 Nov 2018;
- Strong growth momentum maintained – 23 May 2018.

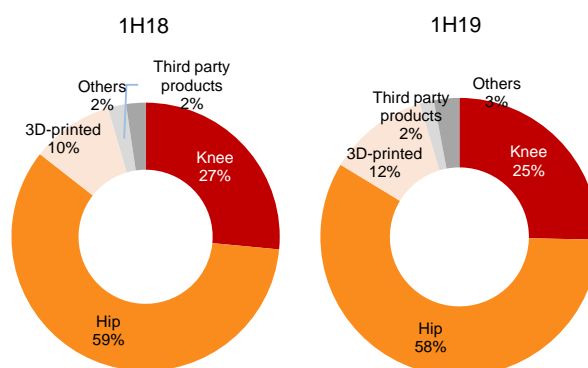
Focus Charts

Figure 1: Overall revenue forecasts



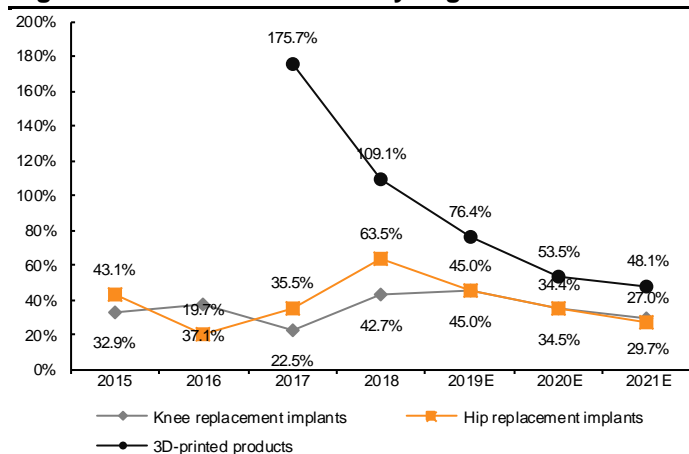
Source: Company data, CMBIS estimates

Figure 2: FY18 revenue breakdown



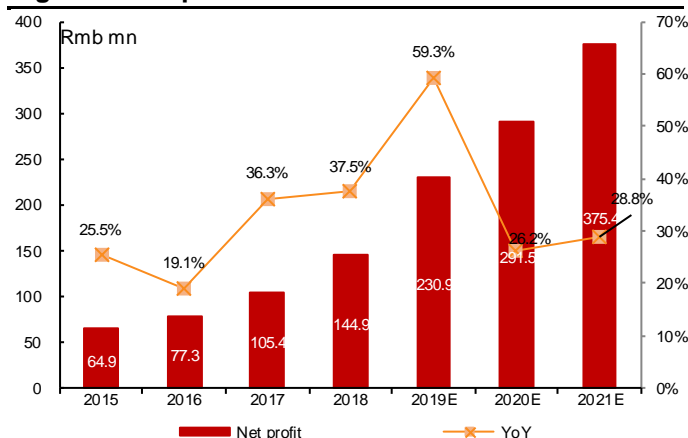
Source: Company data, CMBIS estimates

Figure 3: Revenue forecasts by segment



Source: Company data, CMBIS estimates

Figure 4: Net profit forecasts



Source: Company data, CMBIS estimates

Figure 5: 1H19 results

	1H18 RMB mn	1H19 RMB mn	YoY Change
Knee replacement implants	73	111	52.1%
Hip replacement implants	162	256	57.3%
3D-printed products	27	51	88.2%
Third party orthopedic products	6	7	20.0%
Other	6	13	102.0%
Total revenue	275	438	59.2%
COGS	(84)	(133)	58.2%
Gross profit	191	305	59.6%
Other income	0	16	3360.1%
Distribution expenses	(50)	(84)	68.2%
Administrative expenses	(36)	(48)	33.5%
R&D expenses	(20)	(35)	79.6%
Operating profit	86	153	78.2%
Net finance costs	2	3	64.7%
Profit before tax	88	156	77.9%
Income tax	(17)	(27)	62.4%
Minority interest	0	0	N/A
Net profit	71	130	81.5%
Adjusted net profit	71	114	60.7%
Gross margin	69.4%	69.6%	+0.2ppt
Operating margin	31.2%	35.0%	+3.7ppt
Net margin	26.0%	29.6%	+3.6ppt

Source: Company data, CMBIS estimates; Adjusted net profit excluded one-off item.

Figure 6: CMBI estimate change

	2019E			2020E		
	Old RMB mn	New RMB mn	Change	Old RMB mn	New RMB mn	Change
Knee replacement implants	190	210	10.9%	243	283	16.3%
Hip replacement implants	465	510	9.7%	596	686	15.1%
3D-printed products	108	123	14.1%	161	189	17.5%
Third party orthopedic products	14	14	0.0%	17	17	0.0%
Other	26	26	0.0%	31	31	0.0%
Total revenue	803	884	10.1%	1,048	1,206	15.1%
COGS	(242)	(266)	9.6%	(310)	(372)	20.2%
Gross profit	561	619	10.3%	739	834	12.9%
Other income	5	20	303.5%	5	5	0.0%
Distribution expenses	(164)	(181)	10.1%	(214)	(247)	15.1%
Administrative expenses	(111)	(110)	-0.2%	(145)	(150)	3.3%
R&D expenses	(72)	(80)	10.1%	(94)	(109)	15.1%
Operating profit	219	268	22.4%	290	334	15.2%
Net finance costs	10	10	3.7%	12	13	4.3%
Profit before tax	229	278	21.5%	302	347	14.8%
Income tax	(39)	(47)	21.5%	(48)	(56)	14.8%
Minority interest	0	0	N/A	0	0	N/A
Net profit	190	231	22%	254	291	15%
Gross margin	69.9%	70.0%	+0.1ppt	70.5%	69.2%	-1.3ppt
Operating margin	27.3%	30.3%	+3.0ppt	27.7%	27.7%	-0ppt
Net margin	23.6%	26.1%	+2.5ppt	24.2%	24.2%	-0.1ppt

Source: Company data, CMBIS estimates

Valuation

Figure 7: DCF valuation

	2019E	2020E	2021E	2022E	2023E
	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn
EBIT	268	334	431	548	694
Less: tax	(47)	(56)	(72)	(91)	(115)
Depreciation and amortization	31	42	52	58	61
CAPEX	(100)	(100)	(50)	(30)	(30)
Change in working capital	91	(104)	(21)	(120)	(31)
FCF	243	116	341	365	578
Terminal value					7,658
Subtotal	243	116	341	365	8,236
Present value of enterprise (RMB mn)	6,120				
Debt & Preferred Stock	0				
Bank deposit and pledged cash	608				
Equity Value	6,728				
Number of shares	1,043				
Value per share (RMB)	6.48				
Value per share (HK\$)	7.20				

Risk free rate	4.0%
Beta	0.90
Risk premium	9.1%
Cost of equity	12.2%
Cost of debt	6.0%
WACC	10.8%
Terminal growth rate	3.0%

Source: Company data, CMBIS

Figure 8: Sensitivity analysis

Terminal growth / WACC	9.3%	9.8%	10.3%	10.8%	11.3%	11.8%	12.3%
1.5%	7.50	7.00	6.60	6.30	6.00	5.70	5.40
2.0%	7.90	7.40	7.00	6.60	6.20	5.90	5.60
2.5%	8.40	7.80	7.30	6.90	6.50	6.10	5.80
3.0%	9.00	8.30	7.70	7.20	6.80	6.40	6.10
3.5%	9.60	8.80	8.20	7.60	7.10	6.70	6.30
4.0%	10.40	9.50	8.70	8.10	7.50	7.10	6.60
4.5%	11.30	10.30	9.40	8.60	8.00	7.40	7.00

Source: Company data, CMBIS estimates

Figure 9: Peers' valuation

Company	Ticker	Price Local currency	Mkt cap Local currency mn	PER(x)			PBR(x)			EV/EBITDA (x)			ROE %		
				FY18A	FY19E	FY20E	FY18A	FY19E	FY20E	FY18A	FY19E	FY20E	FY18A	FY19E	FY20E
AK Medical H share	1789	6.29	6,566	40.4	25.4	20.1	7.0	5.8	4.8	30.5	19.9	15.8	17.2	23.0	23.9
Chunli Medical	1858	25.45	3,521	12.0	23.3	18.5	2.0	4.4	3.7	7.2	16.8	12.2	18.1	19.3	20.3
Weigao Group	1066	7.54	34,098	16.9	17.6	15.2	1.7	2.0	1.8	11.3	13.0	12.5	10.6	11.3	11.8
Microport	853	6.49	10,434	60.3	36.0	26.7	3.6	2.9	2.6	22.2	15.5	15.2	5.7	8.1	10.1
PW Medtech	1358	1.00	1,569	12.2	4.8	N/A	0.3	0.5	N/A	35.4	N/A	N/A	45.9	9.7	N/A
Haohai Biotech	6826	35.45	5,674	13.3	11.5	9.9	1.5	1.1	1.0	N/A	6.8	5.3	12.2	10.7	11.4
Lifetech	1302	1.46	6,307	47.0	44.5	29.0	4.6	4.2	3.4	28.2	N/A	N/A	10.6	12.4	14.3
Sisram Med	1696	3.45	1,525	10.3	N/A	N/A	0.7	0.6	0.5	4.4	N/A	N/A	7.2	7.7	8.4
Average				26.6	23.3	19.9	2.7	2.7	2.6	19.9	14.4	12.2	15.9	12.8	14.3
A share															
Double Medical	002901	38.41	15,438	31.8	33.0	26.2	8.2	9.0	7.5	26.8	N/A	N/A	27.9	27.1	28.2
Shanghai Kinet	300326	11.20	8,090	13.2	26.0	20.4	2.4	2.9	2.5	23.7	N/A	N/A	20.4	11.8	13.1
Average				22.5	29.5	23.3	5.3	5.9	5.0	23.7	23.7	23.7	24.1	19.4	20.6

Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	373	601	884	1,206	1,576
Knee replacement implants	102	145	210	283	367
Hip replacement implants	215	352	510	686	872
3D-printed products	33	70	123	189	281
Third party orthopedic products	15	12	14	17	21
Other	7	22	26	31	36
Cost of sales	(109)	(192)	(266)	(372)	(492)
Gross profit	264	409	619	834	1,084
Other income and gains	3	5	20	5	5
Distribution expenses	(50)	(123)	(181)	(247)	(322)
Administrative expenses	(56)	(74)	(110)	(150)	(193)
R&D expenses	(35)	(46)	(80)	(109)	(142)
Operating profit	125	171	268	334	431
Net finance income / (expenses)	0	3	10	13	16
Exceptional	-	-	-	-	-
Pre-tax profit	125	175	278	347	447
Profits tax	(20)	(30)	(47)	(56)	(72)
Minority interest	-	-	-	-	-
Net profit	105	145	231	291	375

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
EBIT	125	171	268	334	431
D&A	12	21	31	42	52
Change in working capital	(7)	(42)	91	(104)	(21)
Income tax paid	(17)	(24)	(47)	(56)	(72)
Others	3	2	0	-	-
Net cash from operating	117	128	343	216	391
Capex	(52)	(197)	(100)	(100)	(50)
Other	1	(26)	10	13	16
Net cash from investing	(51)	(224)	(90)	(87)	(34)
Net proceeds equity financing	369	53	-	-	-
Dividend paid	(73)	(32)	(67)	(78)	(100)
Others	(2)	(25)	-	-	-
Net cash from financing	295	(4)	(67)	(78)	(100)
Net change in cash	361	(100)	187	50	257
Cash at the beginning of the year	161	517	421	608	658
Exchange difference	(4)	3	-	-	-
Cash at the end	517	421	608	658	914

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	126	268	337	396	393
PP&E	105	166	242	307	311
Intangible assets	10	38	31	24	18
Deferred tax assets	10	13	13	13	13
Other non-current asset	1	51	51	51	51
Current assets	732	825	1,040	1,235	1,655
Inventories	87	166	182	255	337
Trade receivables	121	184	197	268	350
Deposits, prepayments & other receivables	6	18	18	18	18
Available-for-sale financial assets	-	36	36	36	36
Cash and cash equivalents	517	421	608	658	914
Current liabilities	179	228	348	388	531
Payables	138	160	279	320	463
Current tax	13	15	15	15	15
Deferred revenue	23	53	53	53	53
Provision	5	1	1	1	1
Non-current liabilities	10	23	23	23	23
Deferred revenue	8	11	11	11	11
Deferred tax liabilities	2	12	12	12	12
Total net assets	668	842	1,006	1,219	1,495
Minority interest	-	-	-	-	-
Shareholders' equity	668	842	1,006	1,219	1,495

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Knee replacement implants	27.3	24.2	23.8	23.5	23.3
Hip replacement implants	57.8	58.6	57.7	56.9	55.3
3D-printed products	9.0	11.6	14.0	15.7	17.8
Third party orthopedic products	4.0	2.0	1.6	1.4	1.3
Other	2.0	3.6	2.9	2.5	2.3
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratios (%)					
Gross margin	70.8	68.1	70.0	69.2	68.8
Net margin	28.3	24.1	26.1	24.2	23.8
Effective tax rate	16.0	16.9	17.0	16.0	16.0
Balance sheet ratios					
Current ratio (x)	4.1	3.6	3.0	3.2	3.1
Trade receivables turnover days	81	75	80	80	80
Trade payables turnover days	100	91	91	91	91
Inventory turnover days	259	241	247	247	247
Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	15.8	17.2	23.0	23.9	25.1
ROA	12.3	13.3	16.8	17.9	18.3
Per share data					
EPS (RMB)	0.14	0.14	0.22	0.28	0.36
DPS (RMB)	0.10	0.06	0.07	0.08	0.11
BVPS (RMB)	0.9	0.8	1.0	1.2	1.4

Source: Company data, CMBIS estimates

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