

# AK Medical (1789 HK)

## Net profit beat due to significant volume growth post VBP

**1H22 earnings beat.** AK Medical reported 1H22 revenue of RMB531.2mn, up 18.7% YoY, primarily driven by the revenue growth in revision replacement implants and ICOS customised products as well as significant sales volume growth of artificial joints post the implementation of national joint VBP. Gross profit was RMB338.5mn, up 9.8% YoY. Gross profit margin was 63.7%, higher than the previous guidance of 55-60%, thanks to the delayed implementation of VBP and the decline in raw material costs. Attributable net profit was RMB126.0mn, up 13.1%YoY, accounting for 77.8% of our previous full-year forecast mainly driven by higher-than-expected revenue growth and better-than-expected operating margins.

■ **Accelerated hospital coverage thanks to VBP tender wins.** Since Apr 2022, joint VBP has been implemented in most provinces except Shanghai and Anhui. AK Medical has won VBP tenders of approximately 81,000 sets of joint implants, accounting for 15.1% of the total purchase volume in this round of VBP. The tender wins allow the Company to penetrate into a total of 3,497 hospitals, of which 953 are newly covered hospitals. Therefore, the Company successfully expanded its hospital coverage and increased its channel penetration in Class III hospitals, driving strong sales volume growth of joint implant products. In 1H22, sales volume of primary hip system grew by 70% YoY while primary knee system increased by 64% YoY. Strong volume growth has more than offset the negative impact of price cuts, revenue of hip implants and knee implants spinal were RMB328mn/ RMB128mn, up 15.9%/ 16.6% YoY, respectively.

■ **Revision & reconstruction and ICOS customised products are new growth drivers.** AK Medical has consistently focused on product upgrade and innovation, and has become a leading player in revision & reconstruction and customised products market in China. These high-margin products are safe from VBP and provide as the next growth engine for the Company. In 1H22, revision & reconstruction products contributed 22.1% of the total revenue compared to 15.1% in 2021. Sales of ICOS customised products rallied by over 100% YoY in 1H22 and may reach 100% YoY growth in the full-year of 2022. The Company's strengthened channel penetration in Class III hospitals will expedite the growth of its innovative products.

■ **Maintain BUY.** Given the stronger-than-expected earnings in 1H22, we raise our TP from HK\$7.69 to HK\$9.20 based on a 9-year DCF model (WACC:10.24%, terminal growth rate: 3.0%).

### Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	1,035	761	1,150	1,532	1,990
YoY growth (%)	11.7	(26.5)	51.0	33.2	29.9
Net profit (RMB mn)	314.0	92.6	206.9	288.2	418.7
YoY growth (%)	17.6	(70.5)	123.4	39.3	45.3
EPS (Reported) (RMB cents)	28.49	8.32	18.55	25.83	37.53
YoY growth (%)	11.0	(70.8)	122.9	39.3	45.3
P/E (x)	58.0	106.3	32.3	23.2	16.0
Yield (%)	0.2	0.2	0.6	0.9	1.3
ROE (%)	19.9	4.5	9.8	26.1	236.6
Net gearing (%)	(36.3)	(26.9)	(34.6)	(8,698.3)	(275.7)

Source: Company data, Bloomberg, CMBIGM estimates

**BUY (Maintain)**

**Target Price** HK\$9.20

(Previous TP) HK\$7.69

**Up/Downside** 35.0%

**Current Price** HK\$6.82

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### Stock Data

Mkt Cap (HK\$ mn)	7,609.4
Avg 3 mths t/o (HK\$ mn)	5.9
52w High/Low (HK\$)	10.84/3.60
Total Issued Shares (mn)	1115.8

Source: FactSet

### Shareholding Structure

Ximalaya Limited	45.3%
Gaoling Fund	6.4%

Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	11.8%	12.9%
3-mth	46.4%	57.1%
6-mth	27.0%	45.8%

Source: FactSet

### 12-mth Price Performance



Source: FactSet

### Related report:

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Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,150	1,532	1,990	1,045	1,367	1,746	10.0%	12.0%	14.0%
Gross profit	713	935	1,224	627	834	1,082	13.7%	12.0%	13.1%
Operating profit	223	319	473	183	272	389	22.4%	17.5%	21.5%
Net profit	207	288	419	162	238	338	27.7%	21.3%	24.1%
EPS (RMB)	0.19	0.26	0.38	0.15	0.21	0	27.7%	21.3%	24.1%
Gross margin	62.00%	61.00%	61.50%	60.00%	61.00%	62.00%	+2.00 ppt	-6.00 ppt	-2.00 ppt
Operating margin	19.43%	20.83%	23.75%	17.48%	19.87%	22.29%	+1.96 ppt	-10.00 ppt	-0.29 ppt
Net Margin	18.00%	18.81%	21.04%	15.51%	17.38%	19.33%	+2.49 ppt	-8.00 ppt	-0.09 ppt

Source: Company data, CMBIGM estimates

Figure 2: Risk-adjusted DCF valuation

DCF Valuation (in Rmb mn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	223	319	473	572	686	817	964	1,127	1,308
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	190	271	402	486	583	694	819	958	1,112
+ D&A	74	74	74	90	108	128	151	177	205
- Change in working capital	54	-162	-202	-244	-293	-348	-411	-481	-558
- Capex	-80	-80	-80	-97	-116	-138	-163	-191	-221
FCFF	238	103	194	235	282	336	396	463	538
Terminal value									7,652
FCF + Terminal value	238	103	194	235	282	336	396	463	8,190

Terminal growth rate	3.0%
WACC	10.24%
Cost of Equity	12.8%
Cost of Debt	5.0%
Equity Beta	1.0
Risk Free Rate	2.80%
Market Risk Premium	10.0%
Target Debt to Asset ratio	30.0%
Effective Corporate Tax Rate	15.0%

PV of enterprise value (RMB mn)	7,969
Net debt (RMB mn)	(759)
Minority interests (RMB mn)	0
Equity value (RMB mn)	8,729
Equity value (HK\$ mn)	10,269
# of shares outstanding (mn)	1,116
Price per share (HK\$)	9.20

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		9.24%	9.74%	10.24%	10.74%	11.24%
Terminal growth rate	4.0%	12.74	11.44	10.36	9.44	8.66
	3.5%	11.81	10.69	9.74	8.93	8.23
	3.0%	11.03	10.05	9.20	8.48	7.85
	2.5%	10.37	9.49	8.74	8.09	7.51
	2.0%	9.79	9.01	8.33	7.74	7.21

**Figure 4: CMBIGM estimates vs consensus**

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,150	1,532	1,990	1,057	1,378	1,761	8.8%	11.2%	13.0%
Gross Profit	713	935	1,224	634	841	1,092	12.4%	11.2%	12.1%
Operating Profit	223	319	473	194	279	397	15.2%	14.6%	19.1%
Net profit	207	288	419	175	246	345	18.3%	17.4%	21.4%
EPS (RMB)	0.19	0.26	0.38	0.16	0.22	0.31	15.92%	17.41%	21.06%
Gross Margin	62.00%	61.00%	61.50%	60.00%	61.00%	62.00%	2.00 ppt	0.00 ppt	-0.50 ppt
Operating Margin	19.43%	20.83%	23.75%	18.35%	20.21%	22.54%	1.08 ppt	0.62 ppt	+1.21 ppt
Net Margin	18.00%	18.81%	21.04%	16.56%	17.82%	19.59%	1.44 ppt	1.00 ppt	+1.45 ppt

Source: Company data, Bloomberg, CMBIGM estimates

## Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	927	1,035	761	1,150	1,532	1,990
Cost of goods sold	(283)	(321)	(262)	(437)	(597)	(766)
Gross profit	643	715	499	713	935	1,224
Operating expenses	(328)	(346)	(400)	(489)	(615)	(751)
Selling expense	(175)	(154)	(187)	(230)	(291)	(358)
Admin expense	(92)	(83)	(105)	(126)	(161)	(199)
R&D expense	(81)	(105)	(113)	(138)	(169)	(199)
Others	20	(4)	6	5	5	5
Operating profit	316	369	99	223	319	473
EBITDA	na	na	na	na	na	547
EBIT	na	na	na	na	na	473
Net Interest income/(expense)	6	8	9	20	20	20
Pre-tax profit	321	377	109	243	339	493
Income tax	(54)	(63)	(16)	(37)	(51)	(74)
After tax profit	267	314	93	207	288	419
Minority interest	0	0	0	0	0	0
Attributable net profit	267	314	93	207	288	419

  

BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	1,118	1,903	1,934	2,241	2,553	2,975
Cash & equivalents	277	713	476	690	752	880
Account receivables	272	451	388	473	630	818
Inventories	229	361	423	431	524	630
Other current assets	340	378	648	648	648	648
Non-current assets	364	624	671	677	683	688
PP&E	284	364	382	401	419	437
Deferred income tax	15	51	76	76	76	76
Intangibles	36	76	80	67	55	42
Goodwill	29	133	132	132	132	132
Other non-current assets	0	0	0	0	0	0
Total assets	1,482	2,527	2,605	2,917	3,236	3,663
Current liabilities	328	418	489	636	724	816
Short-term borrowings	0	0	0	0	0	0
Account payables	79	146	93	239	327	420
Tax payable	32	42	52	52	52	52
Other current liabilities	217	230	345	345	345	345
Non-current liabilities	38	66	84	84	84	84
Deferred income	13	12	12	12	12	12
Other non-current liabilities	25	54	72	72	72	72
Total liabilities	366	484	574	720	808	901
Share capital	9	9	9	9	9	9
Other reserves	1,107	2,033	2,022	2,188	0	335
Total shareholders equity	1,116	2,043	2,032	2,197	9	344
Minority interest	0	0	0	0	0	0
Total equity and liabilities	1,482	2,527	2,605	2,917	818	1,245

<b>CASH FLOW</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
<b>YE 31 Dec (RMB mn)</b>						
<b>Operating</b>						
Profit before taxation	321	377	109	243	339	493
Depreciation & amortization	28	58	73	74	74	74
Tax paid	(33)	(45)	(29)	(37)	(51)	(74)
Change in working capital	(178)	(186)	31	54	(162)	(202)
Others	6	1	(7)	(20)	(20)	(20)
<b>Net cash from operations</b>	<b>145</b>	<b>205</b>	<b>177</b>	<b>315</b>	<b>180</b>	<b>271</b>
<b>Investing</b>						
Capital expenditure	(107)	(351)	(76)	(80)	(80)	(80)
Net proceeds from disposal of short-term investments	(180)	(548)	(1,039)	0	0	0
Others	15	542	818	20	20	20
<b>Net cash from investing</b>	<b>(272)</b>	<b>(356)</b>	<b>(297)</b>	<b>(60)</b>	<b>(60)</b>	<b>(60)</b>
<b>Financing</b>						
Dividend paid	(32)	(75)	(37)	(41)	(58)	(84)
Net borrowings	2	(2)	0	0	0	0
Proceeds from share issues	0	701	0	0	0	0
Others	9	(13)	(64)	0	0	0
<b>Net cash from financing</b>	<b>(22)</b>	<b>612</b>	<b>(101)</b>	<b>(41)</b>	<b>(58)</b>	<b>(84)</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	421	277	713	476	690	752
Exchange difference	4	(24)	(16)	0	0	0
<b>Cash at the end of the year</b>	<b>277</b>	<b>713</b>	<b>476</b>	<b>690</b>	<b>752</b>	<b>880</b>
<b>GROWTH</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
<b>YE 31 Dec</b>						
Revenue	54.3%	11.7%	(26.5%)	51.0%	33.2%	29.9%
Gross profit	57.3%	11.1%	(30.1%)	42.8%	31.1%	31.0%
Operating profit	84.3%	16.9%	(73.0%)	124.7%	42.8%	48.1%
Net profit	84.2%	17.6%	(70.5%)	123.4%	39.3%	45.3%
<b>PROFITABILITY</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
<b>YE 31 Dec</b>						
Gross profit margin	69.4%	69.0%	65.6%	62.0%	61.0%	61.5%
Operating margin	34.0%	35.6%	13.1%	19.4%	20.8%	23.8%
EBITDA margin	na	na	na	na	na	27.5%
Return on equity (ROE)	27.3%	19.9%	4.5%	9.8%	26.1%	236.6%
<b>GEARING/LIQUIDITY/ACTIVITIES</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
<b>YE 31 Dec</b>						
Net debt to equity (x)	(0.2)	(0.4)	(0.3)	(0.3)	(87.0)	(2.8)
Current ratio (x)	3.4	4.6	4.0	3.5	3.5	3.6
Receivable turnover days	81.1	127.3	201.0	150.0	150.0	150.0
Inventory turnover days	254.8	335.6	545.4	360.0	320.0	300.0
Payable turnover days	86.8	127.8	166.0	200.0	200.0	200.0
<b>VALUATION</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
<b>YE 31 Dec</b>						
P/E	19.7	58.0	106.3	32.3	23.2	16.0
P/E (diluted)	20.0	58.3	107.1	32.3	23.2	16.0
Div yield (%)	1.4	0.2	0.2	0.6	0.9	1.3

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

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