

AK Medical (1789 HK)

Solid growth driven by increasing non-VBP sales

1H23 earnings was in line with CMBI and consensus estimates. AK Medical reported 1H23 revenue of RMB648.7mn, up 22.1% YoY, primarily driven by the significant revenue growth of knee replacement implants and non-VBP products. Gross profit was RMB338.5mn, up 9.8% YoY. Gross profit margin fell 1.8 pts to 61.9% (vs. 63.7% in 1H22) due to the implementation of national VBP of joint implants since April 2022. Attributable net profit was RMB132.6mn, up 5.2% YoY, and the attributable net profit margin dropped by 3.3 pts to 20.4% in 1H23 (vs. 23.7% in 1H22) mainly due to the lower GPM and increased administrative expense rate (11.6% in 1H23 vs. 10.3% in 1H22).

■ **Robust growth in knee replacement implants.** Thanks to the sustained market share gain from foreign brands after the national joint VBP and the orthopedic surgery demand recovery, sales volume of the primary knee system increased by 107% YoY. Sales of knee unicondyle replacement system, which is a new partial knee product approved in July 2022, reached RMB33.8mn in 1H23. As a result, AK Medical's revenue from knee replacement implants surged by 64.7% YoY to RMB211.0mn in 1H23. Moreover, AK Medical continued to penetrate into higher-tier hospitals. Approximately 16% of the implant volumes occurred in provincial hospitals in 1H23, up from 10% in 1H22. We expect this trend will further drive the strong sales growth of knee replacement implants in coming years.

■ **Improved revenue mix with increasing proportion of revenue from high-margin non-VBP products.** AK Medical has a comprehensive orthopedic implants portfolios including various products that are safe from VBP such as revision and reconstruction products, 3D-printed spinal implants, partial knee products and customized products (ICOS) etc. The domestic sales of revision products grew by over 60% YoY in 1H23, contributing 26% of the Company's total domestic revenue. The ICOS products realized RMB27.8mn of sales with four NMPA-approved 3D-printing customized products and 62 customized products filings with cooperating hospitals, up 31.5% YoY in 1H23. As a result, 48% of the domestic revenue was from the non-VBP products in 1H23, compared to approximately 36% in 1H22. Besides, the overseas market continued strong growth momentum and the overseas revenue increased by 78.3% YoY to RMB113.5mn in 1H23. Thus, we think 56.8% of AK Medical's total revenue was not VBP-relevant while contributed higher margin than VBP products.

■ **Valuation/Key risks.** To factor in the challenging business environment in China, we revised our TP to HK\$8.46 based on a 9-year DCF model (WACC: 11.08%, terminal growth rate: 2.0%).

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	761	1,052	1,368	1,777	2,315
YoY growth (%)	(26.5)	38.2	30.0	29.9	30.3
Net profit (RMB mn)	93	205	269	342	449
YoY growth (%)	(70.5)	121.1	31.2	27.4	31.2
EPS (Reported) (RMB)	0.08	0.18	0.24	0.31	0.40
YoY growth (%)	(70.8)	121.8	29.8	27.4	31.2
P/E (x)	58.1	26.2	20.2	15.8	12.1
Yield (%)	0.4	1.1	1.2	1.6	2.1
ROE (%)	4.6	9.1	11.0	12.7	14.7
Net gearing (%)	(26.9)	(28.0)	(24.4)	(22.8)	(22.0)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$8.46**

(Previous TP) **HK\$12.31**

Up/Downside **48.7%**

Current Price **HK\$5.69**

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Stock Data

Mkt Cap (HK\$ mn)	6,379.7
Avg 3 mths t/o (HK\$ mn)	20.8
52w High/Low (HK\$)	11.08/5.58
Total Issued Shares (mn)	1121.2

Source: FactSet

Shareholding Structure

Ximalaya Limited	45.3%
Gaoling Fund	6.4%

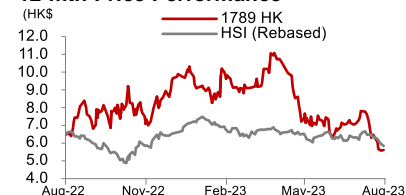
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-20.2%	-14.7%
3-mth	-25.6%	-19.0%
6-mth	-42.1%	-33.9%

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	1,368	1,777	2,315	1,414	1,870	2,434	-3.2%	-5.0%	-4.9%
Gross profit	834	1,088	1,422	855	1,141	1,497	-2.4%	-4.6%	-5.0%
Operating profit	305	392	516	300	412	558	1.8%	-5.0%	-7.5%
Net profit	269	342	449	272	367	491	-1.2%	-6.8%	-8.6%
EPS (RMB)	0.24	0.31	0.40	0.24	0.33	0.44	-1.6%	-7.2%	-9.0%
Gross margin	61.00%	61.20%	61.40%	60.50%	61.00%	61.50%	+0.50 ppt	+0.20 ppt	-0.10 ppt
Operating margin	22.32%	22.03%	22.28%	21.21%	22.03%	22.91%	+1.11 ppt	-0.01 ppt	-0.63 ppt
Net Margin	19.64%	19.26%	19.39%	19.23%	19.64%	20.17%	+0.41 ppt	-0.38 ppt	-0.78 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	305	392	516	645	800	984	1,200	1,452	1,742
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	260	333	439	548	680	836	1,020	1,234	1,481
+ D&A	80	80	80	96	115	135	159	184	211
- Change in working capital	-199	-203	-247	-297	-353	-416	-487	-565	-650
- Capex	-115	-115	-115	-138	-164	-194	-227	-263	-302
CCFF	26	95	157	210	277	361	465	590	740
Terminal value									8,319
FCF + Terminal value	26	95	157	210	277	361	465	590	9,059

Terminal growth rate	2.0%
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)	7,939
Net debt (RMB mn)	(596)
Minority interests (RMB mn)	0
Equity value (RMB mn)	8,535
Equity value (HK\$ mn)	9,484
# of shares outstanding (mn)	1,121
Price per share (HK\$)	8.46

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		10.08%	10.58%	11.08%	11.58%	12.08%
Terminal growth rate	3.0%	11.14	10.17	9.32	8.59	7.94
	2.5%	10.50	9.63	8.87	8.19	7.60
	2.0%	9.95	9.15	8.46	7.84	7.30
	1.5%	9.46	8.73	8.09	7.53	7.02
	1.0%	9.02	8.36	7.77	7.24	6.77

Figure 4: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	1,368	1,777	2,315	1,413	1,820	2,256	-3.2%	-2.3%	2.6%
Gross Profit	834	1,088	1,422	838	1,082	1,198	-0.5%	0.5%	18.7%
Operating Profit	305	392	516	293	406	600	4.1%	-3.6%	-14.0%
Net profit	269	342	449	265	360	542	1.4%	-4.9%	-17.2%
EPS (RMB)	0.24	0.31	0.40	0.24	0.32	0.49	0.7%	-5.2%	-18.3%
Gross Margin	61.00%	61.20%	61.40%	59.32%	59.46%	53.10%	+1.68 ppt	+1.74 ppt	+8.30 ppt
Operating Margin	22.32%	22.03%	22.28%	20.76%	22.32%	26.60%	+1.55 ppt	-0.29 ppt	-4.31 ppt
Net Margin	19.64%	19.26%	19.39%	18.75%	19.77%	24.02%	+0.88 ppt	-0.51 ppt	-4.63 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	1,368	1,777	2,315
Cost of goods sold	(321)	(262)	(416)	(533)	(690)	(894)
Gross profit	715	499	636	834	1,088	1,422
Operating expenses	(346)	(400)	(416)	(529)	(696)	(906)
Selling expense	(154)	(187)	(180)	(239)	(320)	(417)
Admin expense	(83)	(105)	(118)	(157)	(204)	(266)
R&D expense	(105)	(113)	(111)	(144)	(183)	(234)
Others	(4)	6	(7)	11	11	11
Operating profit	369	99	220	305	392	516
Net financial income	8	9	20	11	11	12
Pre-tax profit	377	109	240	316	403	528
Income tax	(63)	(16)	(36)	(47)	(60)	(79)
Net profit	314	93	205	269	342	449
Minority interest	0	0	0	0	0	0
Attributable net profit	314	93	205	269	342	449

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	1,903	1,934	2,065	2,238	2,507	2,871
Cash & equivalents	713	476	626	594	613	668
Account receivables	451	388	467	562	682	825
Inventories	361	423	402	512	642	808
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	442	489	551
Short-term borrowings	0	0	0	0	0	0
Account payables	146	93	155	161	208	269
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	536	583	645
Share capital	9	9	9	9	9	9
Other reserves	2,033	2,022	2,234	2,436	2,692	3,029
Minority interest	0	0	0	0	0	0
Total shareholders equity	2,043	2,032	2,244	2,445	2,702	3,039
Total equity and liabilities	494	583	540	546	593	654

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	377	109	240	316	403	528
Depreciation & amortization	58	73	79	80	80	80
Tax paid	(45)	(29)	(57)	(47)	(60)	(79)
Change in working capital	(186)	31	(40)	(199)	(203)	(247)
Others	1	(7)	22	(11)	(11)	(12)
Net cash from operations	205	177	243	140	208	270
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	11	11	12
Net cash from investing	(356)	(297)	(82)	(104)	(104)	(103)
Financing						
Dividend paid	(75)	(37)	(24)	(67)	(86)	(112)
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)	(67)	(86)	(112)
Net change in cash						
Cash at the beginning of the year	277	713	476	626	594	613
Exchange difference	(24)	(16)	26	0	0	0
Cash at the end of the year	713	476	626	594	613	668
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	11.7%	(26.5%)	38.2%	30.0%	29.9%	30.3%
Gross profit	11.1%	(30.1%)	27.5%	31.1%	30.3%	30.7%
Operating profit	16.9%	(73.0%)	121.2%	38.8%	28.2%	31.8%
Net profit	17.6%	(70.5%)	121.1%	31.2%	27.4%	31.2%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	69.0%	65.6%	60.5%	61.0%	61.2%	61.4%
Operating margin	35.6%	13.1%	20.9%	22.3%	22.0%	22.3%
Return on equity (ROE)	15.4%	4.6%	9.1%	11.0%	12.7%	14.8%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	(0.4)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)
Current ratio (x)	4.6	4.0	4.7	5.1	5.1	5.2
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	17.0	58.1	26.2	20.2	15.8	12.1
Div yield (%)	0.7	0.4	1.1	1.2	1.6	2.1
EV	na	na	na	na	5,136.9	5,081.9
EV/Sales	na	na	na	na	2.9	2.2

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

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