

# AK Medical (1789 HK)

## Channel destocking may continue

- 1H21 earnings miss.** AK medical's 1H21 earnings missed market expectation as the Company expects a 10% / 35% YoY decrease in its revenue/ attributable net profit in 1H21. This translates into approximately RMB431mn revenue and RMB105mn attributable net profit in 1H21, accounting for 35%/29% of our full-year estimates. The weak performance in 1H21 was mainly due to the channel destocking triggered by impact of the COVID-19 pandemic and the upcoming national volume based procurement (VBP). We estimate that the current channel inventory level is about 4-5 months vs the normal level of 3 months. Thus, destocking may continue in 2H21 because distributors expect meaningful price cuts during the national VBP. Meanwhile, we estimate the end demand to remain healthy and the joint surgery volume may have recovered in 1H21.
- National VBP to release results in 3Q21.** In Jun 2021, the NHTA released detailed rules about the national VBP of joint implants. We expect the tender results to come out in 3Q21 while the execution may start from this year-end. Different from the national VBP of coronary stents in Nov 2020, we think the competition is less fierce for the national VBP of joint implants because the percentage of elimination is low. In addition, the A/B grouping bidding rules make larger domestic players especially AK medical has higher chances to win the tenders.
- 3D printed products to continue solid growth.** AK Medical is a leading player in 3D printed products. As of end-2020, the Company held three Class III medical device registration certificates for 3D printed standardized products. The Company also obtained the first two registration certificates for 3D printed customized products from the NMPA in 2020. Given that 3D printed products are not compulsorily included in the national VBP, we expect the Company's 3D printed products to maintain solid growth driven by growing demand and stable pricing.
- Maintain BUY.** We trimmed FY21/22E attributable net profit forecasts by 17%/ 24% to reflect the impact from channel destocking and the coming national VBP. We cut our DCF-based TP from HK\$12.95 to HK\$12.14 (WACC 10.0%, Terminal growth 3.0%).
- Catalysts:** 1) Tender wins in national VBP, 2) new product approvals. **Risk:** worse-than-expected price cut in national VBP.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	927	1,035	1,026	1,219	1,571
YoY growth (%)	54.3	11.7	-0.9	18.9	28.9
Net income (RMB mn)	267	314	302	360	488
EPS (RMB)	0.26	0.28	0.27	0.32	0.44
YoY growth (%)	83.8	11.0	-5.1	19.2	35.7
Consensus EPS (RMB)	N/A	N/A	0.33	0.38	0.43
P/E (x)	34.3	30.9	32.5	27.3	20.1
P/B (x)	8.2	4.7	4.4	4.0	3.5
Yield (%)	1.2	1.2	1.1	1.3	1.7
ROE (%)	23.9	15.4	13.5	14.5	17.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Maintain)**

<b>Target Price</b>	<b>HK\$12.14</b>
(Previous TP)	HK\$12.95
<b>Up/Downside</b>	<b>+14.52%</b>
<b>Current Price</b>	<b>HK\$10.60</b>

### China Healthcare Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	11,824
Avg 3 mths t/o (HK\$ mn)	119.02
52w High/Low (HK\$)	26.25/8.80
Total Issued Shares (mn)	1,116

Source: Bloomberg

#### Shareholding Structure

Management	55.24%
Hillhouse	6.79%
Free float	37.23%

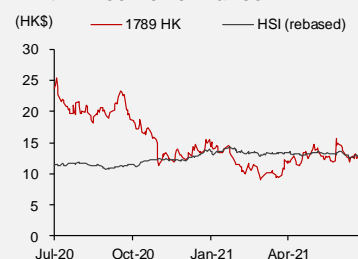
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-9.3%	-2.7%
3-mth	9.2%	16.2%
6-mth	-13.9%	-4.9%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

**Auditor: KPMG**

**Web-site: [www.ak-medical.net](http://www.ak-medical.net)**

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Figure 1: CMBIS earnings revisions

(RMB mn)	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,026	1,219	1,571	1,217	1,535	1,978	-15.7%	-20.6%	-20.6%
Gross profit	687	817	1,084	816	1,059	1,384	-15.7%	-22.9%	-21.7%
Operating profit	354	423	577	427	562	735	-17.2%	-24.7%	-21.5%
Net profit	302	360	488	363	475	619	-16.9%	-24.4%	-21.2%
EPS (RMB)	0.27	0.32	0.44	0.33	0.43	0.56	-16.9%	-24.4%	-21.2%
Gross margin	67.00%	67.00%	69.00%	67.00%	69.00%	70.00%	+0.00ppt	-2.00 ppt	-1.00 ppt
Operating margin	34.49%	34.71%	36.72%	35.11%	36.63%	37.15%	-0.62 ppt	-1.92 ppt	-0.43 ppt
Net Margin	29.41%	29.49%	31.04%	29.82%	30.97%	31.31%	-0.42 ppt	-1.48 ppt	-0.28 ppt

Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

(RMB mn)	New			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,026	1,219	1,571	1,179	1,299	1,608	-13.0%	-6.1%	-2.3%
Gross profit	687	817	1,084	790	864	1,067	-13.0%	-5.4%	1.6%
Operating profit	354	423	577	379	496	646	-6.5%	-14.6%	-10.6%
Net profit	302	360	488	354	381	482	-14.7%	-5.6%	1.2%
EPS (RMB)	0.27	0.32	0.44	0.33	0.38	0.43	-19.0%	-14.7%	1.0%
Gross margin	67.00%	67.00%	69.00%	67.00%	66.50%	66.36%	+0.00ppt	+0.50 ppt	+2.64 ppt
Operating margin	34.49%	34.71%	36.72%	32.10%	38.14%	40.14%	+2.38 ppt	-3.43 ppt	-3.42 ppt
Net Margin	29.41%	29.49%	31.04%	29.98%	29.33%	29.96%	-0.58 ppt	+0.16 ppt	+1.08 ppt

Source: Company data, CMBIS estimates

Figure 3: Peers' valuation

Company	Ticker	Rating	Mkt cap HK\$m	PER(x)		PBR(x)		EV/EBITDA (x)		ROE(%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
AK Medical	1789 HK	BUY	11,824	37.3	31.3	5.0	4.5	25.6	23.4	13.5	14.5
Kindly Medical	1501 HK	BUY	5,594	31.9	24.7	3.3	3.0	N/A	N/A	9.4	10.7
Venus Medtech	2500 HK	BUY	22,178	651.6	81.3	4.2	4.0	274.1	54.3	(1.1)	1.9
Weigao Group	1066 HK	NR	64,488	21.2	18.0	2.7	2.4	13.6	11.3	13.2	14.2
Microport	0853 HK	NR	100,027	N/A	N/A	11.0	10.9	N/A	N/A	(10.6)	(7.5)
Lifetech	1302 HK	NR	20,362	67.9	61.1	6.5	5.9	N/A	N/A	9.0	9.5
Chunli Medical	1858 HK	NR	6,329	16.9	13.5	3.8	3.0	11.8	8.6	25.3	25.0
<b>Peers average :</b>				<b>157.9</b>	<b>39.7</b>	<b>5.3</b>	<b>4.9</b>	<b>99.8</b>	<b>24.8</b>	<b>7.5</b>	<b>8.9</b>

Source: Bloomberg (As at 27 July 2021, CMBIS estimates)

## Valuation

Figure 1: DCF valuation

DCF Valuation (in RMB mn)	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	354	423	577	704	845	997	1,156	1,318	1,476	1,624
Less: tax	(60)	(72)	(97)	(113)	(135)	(159)	(185)	(211)	(236)	(260)
Depreciation and amortisation	40	40	40	47	56	65	74	85	98	113
CAPEX	(100)	(100)	(100)	(118)	(139)	(163)	(186)	(214)	(246)	(282)
Change in working capital	285	(17)	(28)	(32)	(38)	(45)	(51)	(59)	(68)	(78)
FCF	519	274	392	488	588	695	809	920	1,025	1,117
Terminal value										16,360
Subtotal	519	274	392	488	588	695	809	920	1,025	17,477
% change in EBIT				22%	20%	18%	16%	14%	12%	10%
% change in D&A, working capital, CAPEX				18%	18%	17%	14%	15%	15%	15%
PV of enterprise (RMB mn)	10,077									
Net debt (RMB mn)	(1,162)									
Equity value (RMB mn)	11,239									
Equity value (HK\$ mn)	13,541									
Number of shares (mn)	1,116									
Price per share (HK\$)	12.14									
<b>Terminal growth rate</b>	<b>3.0%</b>									
<b>WACC</b>	<b>10.03%</b>									
Cost of equity	12.5%									
Cost of debt	5.0%									
Equity Beta	0.9									
Risk free rate	3.98%									
Market Risk premium	9.50%									
Target Debt to Asset ratio	30.0%									
Effective Corporate Tax Rate	16.0%									

Source: Company data, CMBIS estimates

Figure 2: Sensitivity analysis (HK\$)

Terminal growth rate	WACC				
	9.0%	9.5%	10.0%	10.5%	11.0%
2.0%	12.94	12.03	11.24	10.54	9.92
2.5%	13.54	12.53	11.66	10.90	10.23
3.0%	14.24	13.11	12.14	11.30	10.57
3.5%	15.08	13.78	12.69	11.76	10.96
4.0%	16.07	14.58	13.34	12.30	11.40

Source: Company data, CMBIS estimates

## Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>927</b>	<b>1,035</b>	<b>1,026</b>	<b>1,219</b>	<b>1,571</b>	<b>EBIT</b>	<b>316</b>	<b>369</b>	<b>354</b>	<b>423</b>	<b>577</b>
Knee replacement implants	230	258	245	294	382	D&A	32	61	40	40	40
Hip replacement implants	544	571	542	624	798	Change in working capital	(178)	(186)	285	(17)	(28)
3D-printed products	123	126	151	205	282	Income tax paid	(33)	(45)	(60)	(72)	(97)
Third party orthopedic products	-	52	57	66	75	Others	8	7	(0)	-	-
Other	29	28	30	31	33	<b>Net cash from operating</b>	<b>145</b>	<b>205</b>	<b>619</b>	<b>374</b>	<b>492</b>
Cost of sales	(283)	(321)	(339)	(402)	(487)	Capex	(107)	(351)	(100)	(100)	(100)
<b>Gross profit</b>	<b>643</b>	<b>715</b>	<b>687</b>	<b>817</b>	<b>1,084</b>	Other	(165)	(6)	8	8	8
Other income and gains	20	5	5	5	5	<b>Net cash from investing</b>	<b>(272)</b>	<b>(356)</b>	<b>(92)</b>	<b>(92)</b>	<b>(92)</b>
Distribution expenses	(175)	(154)	(154)	(183)	(236)	Net proceeds equity financing	-	701	-	-	-
Administrative expenses	(92)	(83)	(82)	(94)	(119)	Dividend paid	(32)	(75)	(106)	(126)	(171)
R&D expenses	(81)	(105)	(103)	(122)	(157)	Others	10	(14)	-	-	-
<b>Operating profit</b>	<b>316</b>	<b>369</b>	<b>354</b>	<b>423</b>	<b>577</b>	<b>Net cash from financing</b>	<b>(22)</b>	<b>612</b>	<b>(106)</b>	<b>(126)</b>	<b>(171)</b>
Net finance income / (expenses)	6	8	8	8	8	<b>Net change in cash</b>	<b>(149)</b>	<b>461</b>	<b>422</b>	<b>157</b>	<b>229</b>
Exceptional	-	-	-	-	-	Cash at the beginning of the year	421	277	713	1,135	1,291
<b>Pre-tax profit</b>	<b>321</b>	<b>377</b>	<b>362</b>	<b>431</b>	<b>585</b>	Exchange difference	4	(24)	-	-	-
Profits tax	(54)	(63)	(60)	(72)	(97)	<b>Cash at the end</b>	<b>277</b>	<b>713</b>	<b>1,135</b>	<b>1,291</b>	<b>1,521</b>
Minority interest	-	-	-	-	-						
<b>Net profit</b>	<b>267</b>	<b>314</b>	<b>302</b>	<b>360</b>	<b>488</b>						

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Non-current assets</b>	<b>364</b>	<b>624</b>	<b>684</b>	<b>744</b>	<b>804</b>	<b>Sales mix (%)</b>					
PP&E	284	364	434	504	574	Knee replacement implants	24.8	24.9	23.9	24.1	24.3
Intangible assets	36	76	66	56	46	Hip replacement implants	58.7	55.1	52.9	51.2	50.8
Deferred tax assets	15	51	51	51	51	3D-printed products	13.3	12.2	14.8	16.8	18.0
Other non-current asset	-	-	-	-	-	Third party orthopedic products	-	5.0	5.6	5.4	4.8
						Other	3.1	2.7	2.9	2.6	2.1
<b>Current assets</b>	<b>1,118</b>	<b>1,903</b>	<b>2,002</b>	<b>2,229</b>	<b>2,582</b>	<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Inventories	229	361	278	309	360	<b>Profit &amp; loss ratios (%)</b>					
Trade receivables	356	552	313	352	425	Gross margin	69.4	69.0	67.0	67.0	69.0
Deposits, prepayments & other receivables	34	34	34	34	34	Net margin	28.8	30.3	29.4	29.5	31.0
Available-for-sale financial assets	222	188	188	188	188	Effective tax rate	16.9	16.6	16.6	16.6	16.6
Cash and cash equivalents	277	713	1,135	1,291	1,521	<b>Balance sheet ratios</b>					
<b>Current liabilities</b>	<b>328</b>	<b>418</b>	<b>381</b>	<b>434</b>	<b>531</b>	Current ratio (x)	3.4	4.6	5.3	5.1	4.9
Payables	250	318	281	334	431	Trade receivables turnover days	75	75	75	75	75
Current tax	32	42	42	42	42	Trade payables turnover days	81	100	100	100	100
Contract liabilities	41	46	46	46	46	Inventory turnover days	255	336	300	280	270
Provision	6	-	-	-	-	Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Non-current liabilities</b>	<b>38</b>	<b>66</b>	<b>66</b>	<b>66</b>	<b>66</b>	<b>Returns (%)</b>					
Deferred revenue	13	12	12	12	12	ROE	23.9	15.4	13.5	14.5	17.5
Deferred tax liabilities	25	39	39	39	39	ROA	18.0	12.4	11.2	12.1	14.4
<b>Total net assets</b>	<b>1,116</b>	<b>2,043</b>	<b>2,239</b>	<b>2,473</b>	<b>2,790</b>	<b>Per share data</b>					
Minority interest	-	-	-	-	-	EPS (RMB)	0.26	0.28	0.27	0.32	0.44
<b>Shareholders' equity</b>	<b>1,116</b>	<b>2,043</b>	<b>2,239</b>	<b>2,473</b>	<b>2,790</b>	DPS (RMB)	0.10	0.10	0.09	0.11	0.15
						BVPS (RMB)	1.1	1.9	2.0	2.2	2.5

Source: Company data, CMBIS estimates

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