

AK Medical (1789 HK)

Results of volume-based procurement to come out in mid-September

- 1H21 top line inline while bottom line missed.** AK medical reported 1H21 revenue of RMB448mn (-6.5% YoY), accounting for 44% of our full-year estimate. Net profit grew 31.6% YoY to RMB111mn, accounting for 37% of our full year estimate. Lower-than-expected net profit was due to 1) increase in selling expense (+25% YoY), G&A expense (+33% YoY), R&D expense (+18% YoY), 2) decline in gross profit margin (70.2% in 1H20 vs 68.9% in 1H21), and 3) channel destocking triggered by impact of the coming national volume-based procurement of joint implants. Thanks to the acquisition of Libel, spinal and trauma implants contributed RMB20mn revenue in 1H21, accounting for 4.5% of the total revenue.
- A/B group results of the national VBP were confirmed.** On 23 Aug, the NHSA disclosed detailed rules about the coming national VBP of joint implants. The total intended procurement volume of hip product is 305,542 units and knee product is 231,976 units. AK Medical has been categorized to Group A for all of the four product groups, including ceramics-on-ceramics (C-on-C) hip joint, ceramics on polyethylene (C-on-P) hip joint, metal-on-polyethylene (M-on-P) hip joint and knee joint. Moreover, AK medical has taken a large share of the intended procurement volume in each product group: C-on-C (12.1% of 126,797 units/24 bidders), C-on-P (16.7% of 142,757 units/31 bidders), M-on-P (18.5% of 35,988 units/42 bidders), knee product (13.3% of 231,976 units/44 bidders). The tender will be carried out on 14 Sep.
- 3D printed products will be long-term growth driver.** In 1H21, 3D printed products contributed 14% of the total revenue (+6% YoY). As of 30 Jun 2021, the Company held a total of eight Class III registration certificates for 3D-printed products approved by NMPA, including six standardized products and two customized products. With its strong innovation capability, we believe AK Medical will sustainably grow its 3D product sales. We forecast 3D printed products will contribute 15%/ 17%/ 18% of the total revenue in FY21E/22E/23E, respectively. In addition, Hip Hemiarthroplasty products and repair products are not included in the national VBP, which gave AK medical good opportunities to grow the sales of these products.
- Maintain BUY.** We trimmed our FY21/22E/23E attributable net profit forecasts by 15%/ 21%/ 27% to reflect the potential impact from national VBP. We cut our DCF-based TP from HK\$12.14 to HK\$9.62 (WACC 10.0%, Terminal growth 3.0%). We believe the Company will resume solid growth after FY22E thanks to its comprehensive product portfolio and strong innovation capability.
- Catalysts:** 1) Tender wins in national VBP, 2) New product approvals. **Risks:** worse-than-expected price cuts in national VBP.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	927	1,035	971	998	1,157
YoY growth (%)	54.3	11.7	-6.2	2.7	15.9
Net income (RMB mn)	267	314	254	285	358
EPS (RMB)	0.26	0.28	0.23	0.26	0.32
YoY growth (%)	83.8	11.0	-20.1	12.4	25.4
Consensus EPS (RMB)	N/A	N/A	0.32	0.36	0.40
P/E (x)	26.3	23.7	29.6	26.3	21.0
P/B (x)	6.3	3.6	3.4	3.1	2.8
Yield (%)	1.5	1.5	1.0	1.1	1.4
ROE (%)	23.9	15.4	11.4	11.8	13.4
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$9.62
(Previous TP)	HK\$12.14)
Up/Downside	+18.51%
Current Price	HK\$8.12

China Healthcare Sector

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Stock Data

Mkt Cap (HK\$ mn)	9,058
Avg 3 mths t/o (HK\$ mn)	108.62
52w High/Low (HK\$)	23.50/7.97
Total Issued Shares (mn)	1,116
Source: Bloomberg	

Shareholding Structure

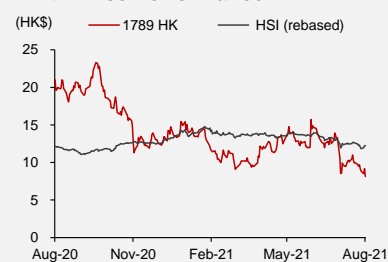
Management	55.24%
Hillhouse	6.79%
Free float	37.23%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	-31.1%	-26.9%
3-mth	-32.1%	-25.1%
6-mth	-21.8%	-9.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Web-site: www.ak-medical.net

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- Solid earnings growth amid COVID-19 pandemic – 24 Mar 2021
- FY19 results in line; Demand remains resilient – 25 Mar 2020
- Mild impact from COVID-19; Demand remains resilient – 12 Feb 2020

Figure 1: CMBIS earnings revisions

(RMB mn)	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	971	998	1,157	1,026	1,219	1,571	-5.3%	-18.2%	-26.4%
Gross profit	661	659	775	687	817	1,084	-3.9%	-19.4%	-28.5%
Operating profit	296	334	421	354	423	577	-16.2%	-21.0%	-27.0%
Net profit	254	285	358	302	360	488	-15.8%	-20.6%	-26.6%
EPS (RMB)	0.23	0.26	0.32	0.27	0.32	0.44	-15.8%	-20.6%	-26.5%
Gross margin	68.00%	66.00%	67.00%	67.00%	67.00%	69.00%	+1.00ppt	-1.00 ppt	-2.00 ppt
Operating margin	30.51%	33.50%	36.43%	34.49%	34.71%	36.72%	-3.97 ppt	-1.21 ppt	-0.29 ppt
Net Margin	26.13%	28.60%	30.95%	29.41%	29.49%	31.04%	-3.28 ppt	-0.89 ppt	-0.09 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	971	998	1,157	1,131	1,220	1,506	-14.1%	-18.2%	-23.2%
Gross profit	661	659	775	758	799	992	-12.8%	-17.6%	-21.9%
Operating profit	296	334	421	342	426	567	-13.3%	-21.5%	-25.7%
Net profit	254	285	358	338	352	449	-25.0%	-19.0%	-20.3%
EPS (RMB)	0.23	0.26	0.32	0.32	0.36	0.40	-29.3%	-28.1%	-20.1%
Gross margin	68.00%	66.00%	67.00%	67.00%	65.50%	65.86%	+1.00ppt	+0.50 ppt	+1.14 ppt
Operating margin	30.51%	33.50%	36.43%	30.24%	34.92%	37.65%	+0.28 ppt	-1.42 ppt	-1.22 ppt
Net Margin	26.13%	28.60%	30.95%	29.91%	28.87%	29.81%	-3.78 ppt	-0.27 ppt	+1.14 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	9,058	35.1	31.2	4.0	3.7	23.0	22.7	11.4	11.8
Kindly Medical	1501 HK	26.60	4,416	25.1	19.5	2.6	2.4	N/A	N/A	9.4	10.7
Venus Medtech	2500 HK	40.35	18,170	N/A	75.4	3.2	3.0	N/A	48.6	(1.0)	1.6
Weigao Group	1066 HK	13.38	60,509	19.8	16.5	2.5	2.3	12.7	10.6	13.2	14.2
Microport	0853 HK	47.80	86,993	N/A	N/A	9.6	9.4	N/A	N/A	(10.6)	(7.5)
Lifetech	1302 HK	4.23	19,582	51.0	39.1	6.3	5.7	N/A	N/A	9.0	9.5
Chunli Medical	1858 HK	19.70	6,813	16.7	14.6	4.0	3.1	12.0	9.6	27.1	24.8
Average :				29.5	32.7	4.6	4.2	15.9	22.9	8.3	9.3

Source: Bloomberg (As at 25 Aug 2021)

Valuation

Figure 4: DCF valuation

DCF Valuation (in RMB mn)	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	296	334	421	518	627	746	873	1,004	1,135	1,259
Less: tax	(51)	(57)	(71)	(83)	(100)	(119)	(140)	(161)	(182)	(202)
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	304	(3)	(11)	(13)	(16)	(18)	(21)	(24)	(27)	(32)
FCF	490	214	279	351	428	511	601	691	778	857
Terminal value										12,553
Subtotal	490	214	279	351	428	511	601	691	778	13,410

PV of enterprise (RMB mn)	7,739
Net debt (RMB mn)	(1,163)
Equity value (RMB mn)	8,902
Equity value (HK\$ mn)	10,726
Number of shares	1,115
Price per share (HK\$)	9.62

Terminal growth rate	3.0%
WACC	10.03%
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 5: Sensitivity analysis (HK\$)

Terminal growth rate	WACC				
	9.0%	9.5%	10.0%	10.5%	11.0%
2.0%	10.23	9.54	8.93	8.40	7.92
2.5%	10.70	9.92	9.25	8.67	8.16
3.0%	11.24	10.37	9.62	8.98	8.42
3.5%	11.87	10.88	10.05	9.34	8.72
4.0%	12.64	11.50	10.55	9.75	9.06

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
Revenue	927	1,035	971	998	1,157	EBIT	316	369	296	334	421
Knee replacement implants	230	258	219	208	229	D&A	32	61	40	40	40
Hip replacement implants	544	571	514	488	537	Change in working capital	(178)	(186)	304	(3)	(11)
3D-printed products	123	126	151	205	282	Income tax paid	(33)	(45)	(51)	(57)	(71)
Third party orthopedic products	-	52	57	66	75	Others	8	7	-	-	-
Other	29	28	30	31	33	Net cash from operating	145	205	590	314	379
Cost of sales	(283)	(321)	(311)	(339)	(382)	Capex	(107)	(351)	(100)	(100)	(100)
Gross profit	643	715	661	659	775	Other	(165)	(6)	8	8	8
Other income and gains	20	5	5	5	5	Net cash from investing	(272)	(356)	(92)	(92)	(92)
Distribution expenses	(175)	(154)	(175)	(150)	(173)	Net proceeds equity financing	-	701	-	-	-
Administrative expenses	(92)	(83)	(97)	(90)	(93)	Dividend paid	(32)	(75)	(76)	(86)	(107)
R&D expenses	(81)	(105)	(97)	(90)	(93)	Others	10	(14)	-	-	-
Operating profit	316	369	296	334	421	Net cash from financing	(22)	612	(76)	(86)	(107)
Net finance income / (expenses)	6	8	8	8	8	Net change in cash	(149)	461	422	137	179
Exceptional	-	-	-	-	-	Cash at the beginning of the year	421	277	713	1,135	1,272
Pre-tax profit	321	377	304	342	429	Exchange difference	4	(24)	-	-	-
Profits tax	(54)	(63)	(51)	(57)	(71)	Cash at the end	277	713	1,135	1,272	1,452
Minority interest	-	-	-	-	-						
Net profit	267	314	254	285	358						

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	364	624	684	744	804	Sales mix (%)					
PP&E	284	364	434	504	574	Knee replacement implants	24.8	24.9	22.6	20.9	19.8
Intangible assets	36	76	66	56	46	Hip replacement implants	58.7	55.1	52.9	48.9	46.4
Deferred tax assets	15	51	51	51	51	3D-printed products	13.3	12.2	15.6	20.5	24.4
Other non-current asset	-	-	-	-	-	Third party orthopedic products	-	5.0	5.9	6.6	6.5
						Other	3.1	2.7	3.1	3.1	2.8
Current assets	1,118	1,903	1,969	2,116	2,350	Total	100.0	100.0	100.0	100.0	100.0
Inventories	229	361	256	260	282	Profit & loss ratios (%)					
Trade receivables	356	552	302	307	340	Gross margin	69.4	69.0	68.0	66.0	67.0
Deposits, prepayments & other receivables	34	34	34	34	34	Net margin	28.8	30.3	26.1	28.6	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	1,272	1,452						
Current liabilities	328	418	366	373	417	Balance sheet ratios					
Payables	250	318	266	273	317	Current ratio (x)	3.4	4.6	5.4	5.7	5.6
Current tax	32	42	42	42	42	Trade receivables turnover days	75	75	75	75	75
Contract liabilities	41	46	46	46	46	Trade payables turnover days	81	100	100	100	100
Provision	6	-	-	-	-	Inventory turnover days	255	336	300	280	270
						Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Non-current liabilities	38	66	66	66	66						
Deferred revenue	13	12	12	12	12	Returns (%)					
Deferred tax liabilities	25	39	39	39	39	ROE	23.9	15.4	11.4	11.8	13.4
						ROA	18.0	12.4	9.6	10.0	11.4
Total net assets	1,116	2,043	2,220	2,420	2,671	Per share data					
Minority interest	-	-	-	-	-	EPS (RMB)	0.26	0.28	0.23	0.26	0.32
Shareholders' equity	1,116	2,043	2,220	2,420	2,671	DPS (RMB)	0.10	0.10	0.07	0.08	0.10
						BVPS (RMB)	1.1	1.9	2.0	2.2	2.4

Source: Company data, CMBIS estimates

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