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AK Medical (1789 HK)

Tender results in line with our expectation

- **Tender results in line with our expectation.** Yesterday, the national volume based procurement (VBP) of joint implants opened bids in Tianjin. A total of 48 companies participated in this tender, resulted in 44 companies were selected, accounting for the winning rate of 92%. We roughly estimate the average price of hip joints cut from 35,000RMB to around 7,000RMB, the average price of knee joints dropped from 32,000RMB to around 5,000RMB, with an average price reduction rate of 82%, which is in line with our last expectation. We estimate the total intended procurement volume of joint implants is around 54,0000 units, accounting for 90% of the total market demand. Recall in Nov 2020, the NHSA initiated the centralized procurement of coronary stents and triggered more than 90% price cuts in stents, this round of VBP is less aggressive than the market expectation.
- **Good results achieved in national VBP.** AK medical's tender has won all four product categories, including ceramic-on-ceramics (C-on-C) hip joints, ceramics on polyethylene (C-on-P) hip joint, metal on polyethylene (M-on-P) hip joint and knee joint. Based on the recent news post, we roughly estimate the Company's bidding price: C-on-C (6,100RMB/unit), C-on-P (5,500RMB/unit), M-on-P (6,000RMB/unit), knee product (4,600 RMB/unit). We estimate AK medical has won 76,185 units of procurement volume from the tender and we believe the Company's bidding price is largely in line with the current ex-factory price. By leveraging the results of this tender, we believe the Company has huge potential to take a large share of the re-distribution volume which is roughly 90,000 units. Including sales volume of Hip Hemiarthroplasty products and repair products, we estimate the Company will achieve around 180,000 units of full-year sales volume by the end of 2021.
- **Strong innovation capability in 3D product.** As of 1H21, the Company held a total of eight Class III registration certificates for 3D-printed products approved by NMPA. We forecast the Company will maintain the R&D expense around 10% of the revenue in FY21E-23E. As of 1H21, 3D printed products contributed 14% of the total revenue. We believe AK Medical will sustainably grow its 3D product.
- **Maintain BUY.** We adjusted our FY21E/22E/23E revenue forecasts by -4%/ 7%/ 19% and revised net profit by -4%/ -11%/ -2% to reflect the impact from national VBP. We are optimistic about its long-term growth outlook. We raise our DCF-based TP from HK$9.62 to HK$11.45 (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 R&D capability.
- **Catalysts:** 1) Tender wins in national VBP, 2) New product approvals. **Risks:** worse-than-expected implementations in national VBP.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	927	1,035	929	1,069	1,377
YoY growth (%)	54.3	11.7	-10.3	15.1	28.9
Net income (RMB mn)	267	314	243	253	350
EPS (RMB)	0.26	0.28	0.22	0.23	0.31
YoY growth (%)	83.8	11.0	-23.4	4.1	38.1
Consensus EPS (RMB)	N/A	N/A	0.28	0.33	0.35
P/E (x)	30.9	27.9	36.4	34.9	25.3
P/B (x)	7.4	4.3	4.0	3.7	3.4
Yield (%)	1.3	1.3	0.8	0.9	1.2
ROE (%)	23.9	15.4	11.0	10.6	13.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	**HK$11.45**
(Previous TP	HK$9.62)
Up/Downside	**+19.75%**
Current Price	**HK$9.56**

China Healthcare Sector

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Stock Data

Mkt Cap (HK$ mn)	10,664
Avg 3 mths t/o (HK$ mn)	101.13
52w High/Low (HK$)	23.50/7.52
Total Issued Shares (mn)	1,116

Source: Bloomberg

Shareholding Structure

Management	55.24%
Hillhouse	6.79%
Free float	37.23%

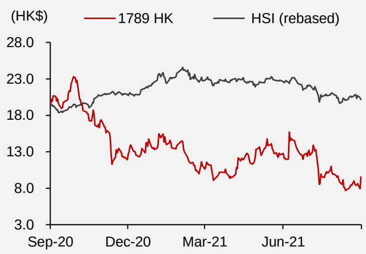
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-4.1%	-0.8%
3-mth	-24.1%	-14.2%
6-mth	-13.9%	-2.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Web-site: www.ak-medical.net

Related Reports

1. Results of volume-based procurement to come out in mid September – 26 Aug 2021
2. Channel destocking may continue – 27 Jul 2021
3. Solid earnings growth amid COVID-19 pandemic – 24 March 2021
4. FY19 results in line; Demand remains resilient – 25 Mar 2020

Figure 1: CMBIS earnings revisions

(RMB mn)	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	929	1,069	1,377	971	998	1,157	-4.4%	7.1%	19.1%
Gross profit	631	695	923	661	659	775	-4.4%	5.5%	19.1%
Operating profit	284	296	411	296	334	421	-4.3%	-11.6%	-2.4%
Net profit	243	253	350	254	285	358	-4.2%	-11.3%	-2.3%
EPS (RMB)	0.22	0.23	0.31	0.23	0.26	0.32	-4.2%	-11.3%	-2.3%
Gross margin	68.00%	65.00%	67.00%	68.00%	66.00%	67.00%	0.00 ppt	-1.00 ppt	0.00 ppt
Operating margin	30.54%	27.67%	29.86%	30.51%	33.50%	36.43%	+0.02 ppt	-5.83 ppt	-6.57 ppt
Net Margin	26.18%	23.69%	25.38%	26.13%	28.60%	30.95%	+0.05 ppt	-4.91 ppt	-5.57 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	929	1,069	1,377	1,051	1,204	1,434	-11.6%	-11.3%	-3.9%
Gross profit	631	695	923	709	768	906	-10.9%	-9.6%	1.9%
Operating profit	284	296	411	313	382	489	-9.4%	-22.5%	-15.8%
Net profit	243	253	350	289	321	394	-15.9%	-21.1%	-11.3%
EPS (RMB)	0.22	0.23	0.31	0.28	0.33	0.35	-22.9%	-30.5%	-10.9%
Gross margin	68.00%	65.00%	67.00%	67.42%	63.80%	63.16%	+0.58 ppt	+1.20 ppt	+3.84 ppt
Operating margin	30.54%	27.67%	29.86%	29.78%	31.69%	34.07%	+0.76 ppt	-4.02 ppt	-4.20 ppt
Net Margin	26.18%	23.69%	25.38%	27.52%	26.66%	27.48%	-1.34 ppt	-2.97 ppt	-2.09 ppt

Source: Company data, CMBIS estimates

Figure 3: Peers' valuation

			Mkt cap	PER(x)		PBR(x)		EV/EBITDA (x)		ROE(%)	
Company	Ticker	Rating	HK$mn	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
AK Medical	**1789 HK**	**BUY**	**12,760**	**36.4**	**34.9**	**4.0**	**3.7**	**23.7**	**25.6**	**11.0**	**10.6**
Kindly Medical	1501 HK	33.70	4,133	23.4	18.2	2.4	2.2	N/A	N/A	9.4	10.7
Venus Medtech	2500 HK	49.25	20,084	N/A	142.0	3.6	3.5	N/A	86.7	(2.7)	1.7
Weigao Group	1066 HK	14.26	61,594	20.3	17.1	2.6	2.3	12.7	10.6	13.0	14.0
Microport	0853 HK	55.05	91,729	N/A	N/A	9.4	9.6	N/A	N/A	(13.5)	(9.4)
Lifetech	1302 HK	4.40	18,888	48.9	37.5	6.0	5.4	N/A	N/A	9.0	9.5
Chunli Medical	1858 HK	18.30	7,609	18.6	16.3	4.4	3.5	13.6	11.0	27.1	24.2
			Average :	**29.5**	**44.3**	**4.6**	**4.3**	**16.6**	**33.5**	**7.6**	**8.8**

Source: Bloomberg (As at 15 Sep 2021)

Valuation

Figure 1: DCF valuation

DCF Valuation (in RMB mn)	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	284	296	411	514	638	784	957	1,158	1,389	1,653
Less: tax	(48)	(50)	(70)	(82)	(102)	(125)	(153)	(185)	(222)	(264)
Depreciation and amortization	40	40	40	50	62	76	93	113	135	161
CAPEX	(80)	(80)	(80)	(100)	(124)	(153)	(186)	(225)	(270)	(322)
Change in working capital	313	(33)	(28)	(35)	(44)	(54)	(65)	(79)	(95)	(113)
FCF	508	172	273	347	430	529	645	781	937	1,115
Terminal value										16,330
Subtotal	508	172	273	347	430	529	645	781	937	17,444

PV of enterprise (RMB mn)	9,407
Net debt (RMB mn)	(1,184)
Equity value (RMB mn)	10,591
Equity value (HK$ mn)	12,760
Number of shares	1,115
Price per share (HK$)	**11.45**
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 2: Sensitivity analysis (HK$)

	WACC				
Terminal growth rate	**9.0%**	**9.5%**	**10.0%**	**10.5%**	**11.0%**
2.0%	12.21	11.32	10.55	9.87	9.27
2.5%	12.82	11.82	10.97	10.22	9.57
3.0%	13.52	12.40	**11.45**	10.63	9.91
3.5%	14.35	13.07	12.00	11.09	10.30
4.0%	15.34	13.87	12.65	11.62	10.75

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**927**	**1,035**	**929**	**1,069**	**1,377**
Knee replacement implants	230	258	219	252	340
Hip replacement implants	544	571	485	534	667
3D-printed products	123	126	139	187	262
Third party orthopedic products	-	52	56	64	74
Other	29	28	29	31	33
Cost of sales	(283)	(321)	(297)	(374)	(455)
Gross profit	**643**	**715**	**631**	**695**	**923**
Other income and gains	20	5	5	5	5
Distribution expenses	(175)	(154)	(167)	(192)	(248)
Administrative expenses	(92)	(83)	(93)	(105)	(131)
R&D expenses	(81)	(105)	(93)	(107)	(138)
Operating profit	**316**	**369**	**284**	**296**	**411**
Net finance income / (expenses)	6	8	8	8	8
Exceptional	-	-	-	-	-
Pre-tax profit	**321**	**377**	**292**	**304**	**419**
Profits tax	(54)	(63)	(48)	(50)	(70)
Minority interest	-	-	-	-	-
Net profit	**267**	**314**	**243**	**253**	**350**

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
EBIT	**316**	**369**	**284**	**296**	**411**
D&A	32	61	40	40	40
Change in working capital	(178)	(186)	313	(33)	(28)
Income tax paid	(33)	(45)	(48)	(50)	(70)
Others	8	7	-	-	0
Net cash from operating	**145**	**205**	**588**	**252**	**353**
Capex	(107)	(351)	(80)	(80)	(80)
Other	(165)	(6)	8	8	8
Net cash from investing	**(272)**	**(356)**	**(72)**	**(72)**	**(72)**
Net proceeds equity financing	-	701	-	-	-
Dividend paid	(32)	(75)	(73)	(76)	(105)
Others	10	(14)	-	-	-
Net cash from financing	**(22)**	**612**	**(73)**	**(76)**	**(105)**
Net change in cash	**(149)**	**461**	**443**	**104**	**177**
Cash at the beginning year	421	277	713	1,156	1,260
Exchange difference	4	(24)	-	-	-
Cash at the end	**277**	**713**	**1,156**	**1,260**	**1,437**

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	**364**	**624**	**664**	**704**	**744**
PP&E	284	364	414	464	514
Intangible assets	36	76	66	56	46
Deferred tax assets	15	51	51	51	51
Other non-current asset	-	-	-	-	-
Current assets	**1,118**	**1,903**	**1,970**	**2,145**	**2,435**
Inventories	229	361	244	287	336
Trade receivables	356	552	293	321	385
Prepayments & other receivables	34	34	34	34	34
Available-for-sale financial	222	188	188	188	188
Cash and cash equivalents	277	713	1,156	1,260	1,437
Current liabilities	**328**	**418**	**354**	**393**	**477**
Payables	250	318	255	293	377
Current tax	32	42	42	42	42
Contract liabilities	41	46	46	46	46
Provision	6	-	-	-	-
Non-current liabilities	**38**	**66**	**66**	**66**	**66**
Deferred revenue	13	12	12	12	12
Deferred tax liabilities	25	39	39	39	39
Total net assets	**1,116**	**2,043**	**2,213**	**2,390**	**2,635**
Minority interest	**-**	**-**	**-**	**-**	**-**
Shareholders' equity	**1,116**	**2,043**	**2,213**	**2,390**	**2,635**

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Knee replacement implants	24.8	24.9	23.6	23.6	24.7
Hip replacement implants	58.7	55.1	52.3	50.0	48.4
3D-printed products	13.3	12.2	15.0	17.5	19.1
Third party orthopedic products	-	5.0	6.0	6.0	5.4
Other	3.1	2.7	3.1	2.9	2.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Profit & loss ratios (%)					
Gross margin	69.4	69.0	68.0	65.0	67.0
Net margin	28.8	30.3	26.2	23.7	25.4
Effective tax rate	16.9	16.6	16.6	16.6	16.6
Balance sheet ratios					
Current ratio (x)	3.4	4.6	5.6	5.5	5.1
Trade receivables turnover	75	75	75	75	75
Trade payables turnover days	81	100	100	100	100
Inventory turnover days	255	336	300	280	270
Net debt to total equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	23.9	15.4	11.0	10.6	13.3
ROA	18.0	12.4	9.2	8.9	11.0
Per share data					
EPS (RMB)	0.26	0.28	0.22	0.23	0.31
DPS (RMB)	0.10	0.10	0.07	0.07	0.09
BVPS (RMB)	1.1	1.9	2.0	2.1	2.4

Source: Company data, CMBIS estimates

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