

2017 年 1 月 10 日

买入
首次覆盖

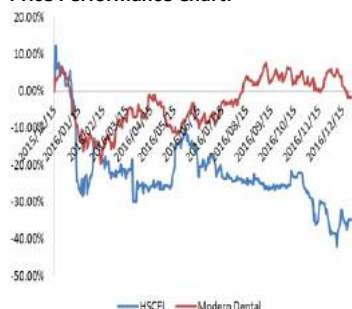
露齿微笑

现代牙科 (3600:HK)

Market Data: 9 January

Closing Price (HK\$)	2.86
Price Target (HK\$)	4.26
HSCEI	9602
HSCCI	3678
52-week High/Low (HK\$)	4.7/2.27
Market Cap (US\$ m)	369
Market Cap (HK\$ m)	2860
Shares Outstanding (Mn)	1000
Exchange Rate (US\$-HK\$)	7.76

Price Performance Chart:



Source: Bloomberg

Analyst

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Financial summary and valuation

	2014	2015	2016E	2017E	2018E
Revenue (HK\$m)	1,192	1,416	1,622	2,193	2,468
YoY (%)		18.74%	14.57%	35.25%	12.50%
Net income (HK\$m)	132	84	146	221	270
YoY (%)		-36.46%	74.76%	50.84%	22.29%
EPS (HK\$)	0.15	0.10	0.17	0.26	0.32
Diluted EPS (HK\$)	0.15	0.10	0.17	0.26	0.32
ROE (%)	0.00	0.07	0.08	0.11	0.13
Debt/asset (%)	66.22	33.28	32.87	33.48	30.39
Dividend yield (%)	0.00	0.00	30.00	30.00	30.00
PE (x)	18.9	28.8	16.4	10.9	8.9
PB (x)	4.1	1.3	1.2	1.2	1.1
EV/Ebitda (x)	12.0	9.1	12.9	8.7	7.1

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

现代牙科是一家全球领先的义齿供应商，专注于为客户定制义齿。公司的主要产品包括固定义齿、活动义齿和其他。在 2016 上半年，公司归属股东净利润达到 7,044 万港元，较去年同期的 5,956 万港元同比增长 18.3%。由于其全球业务扩张，公司未来几年的收入将进一步增加。我们预测公司的每股盈利为在 2016 年为 0.17 港元（同比增长 70%），2017 年为 0.26 港元（同比增长 53%），2018 年为 0.32 港元（同比增长 23%）。我们的目标价为 4.26 港元，公司股价有 49% 的上升空间。因此，我们首次覆盖给予买入评级。

全球战略。为了建立全球性的专有销售和分销网络，现代牙科实施了对前分销商的一系列战略收购，并在全球开发了几个知名品牌。成功的品牌管理助力公司赢得市场份额，成为全球牙科设备领导者。在收入方面，Labocast 在法国市场排名第一，Elysee Dental 在荷兰市场排名第二，在比利时市场排名第一，洋紫荆在中国市场排名第一，现代牙科在香港市场排名第一。管理层表示，公司在接下来的几年将会完成更多的收购，以扩大其全球的市场份额。

中国市场潜力巨大。虽然公司 2016 年上半年近一半收入来源于欧洲市场，我们认为由于中国消费者对口腔健康意识逐渐提升，公司在中国市场拥有巨大潜力（2016 年上半年中国市场收入占比约为 25%）。现代牙科旗下子公司在中国（洋紫荆）和香港（现代牙科）分别占据最大市场份额。由于其优良的品质及良好的发展，公司管理层预计 2017 年中国市场收入增长率可以达到两位数。

利润可观。我们预测 2016 年公司的盈利为 1.46 亿港元（同比增长 74%），2017 年为 2.21 亿港元（同比增长 51%）。2016 年利润大幅增加的主要原因有：（1）欧洲市场收入增长强劲，从 2015 上半年的 3.39 亿港元增长到 2016 年上半年的 3.83 亿港元；（2）人民币贬值，这是记录生产成本的主要货币；（3）不包括 2015 年与上市相关的一次性费用（大约 3260 万港元）；（4）合并 SCDL。SCDL 是澳大利亚的主要分销商，这增强了与客户的直接联系，能够保证具有竞争力的价格。除了有机增长，预计 2017 年利润的增长很大程度上归因于 2016 年 10 月收购 RTFP 牙科，其 2016 年前六个月的收入为 3300-3500 万美元。我们认为完全合并 RTFP 将会大大促进 2017 年的财务状况。

首次覆盖给予买入评级。我们的目标价为 4.26 港元，相当于 2016 年 24.51 倍市盈率 1.86 倍市净率；2017 年 16.25 倍市盈率和 1.72 倍市净率。股价有 49% 的上涨空间，我们首次覆盖给予买入评级。

The company does not hold any equities or derivatives of the listed company mentioned in this report ("target"), but then we shall provide financial advisory services subject to the relevant laws and regulations. Any affiliates of the company may hold equities of the target, which may exceed 1 percent of issued shares subject to the relevant laws and regulations. The company may also provide investment banking services to the target. The Company fulfills its duty of disclosure within its sphere of knowledge. The clients may contact compliance@swsresearch.com for relevant disclosure materials or log into www.swsresearch.com under disclosure column for further information. The clients shall have a comprehensive understanding of the disclosure and disclaimer upon the last page.

Investment highlights

Modern Dental is a dental prosthetic device provider. Its clients are located across the globe and its products include fixed and removable prosthetic devices, as well as other related products. In 1H16, it posted revenue of HK\$774m (+13.7% YoY) and net profit attributable to owners of the company of HK\$70.4m (+18.3% YoY). As the company continues to expand in China and globally, we forecast EPS of HK\$0.17 in 16E (+70% YoY), HK\$0.26 in 17E (+53% YoY) and HK\$0.32 in 18E (+23% YoY). Based on our target price of HK\$4.26, implying 49% upside, we initiate coverage with a BUY rating.

Global strategy. In order to establish a global proprietary sales and distribution network, Modern Dental has acquired many of its distributors in addition to establishing a number of arms worldwide. Its brand Labocast is the leader in France, while Elysee Dental is the top player in Belgium and the second in the Netherlands. Management has guided that it plans on completing more acquisitions in order to increase the firm's global footprint.

The Chinese potential. Although nearly half of the company's revenue in 1H16 stemmed from Europe and we expect most of its expansion to continue to stem from the region in the near-term, we see a big potential for the Chinese market (which contributed c.25% in 1H16) as individuals are becoming more conscious of oral health and the company is increasing its marketing efforts in the country. Modern Dental already benefits from slightly higher price than peers in Greater China, where it is a market leader under its brand Yangzijing on the mainland and Modern Dental in Hong Kong, due to the high-quality of its products and management has guided double-digit growth for the segment in 2017.

Expanding margins. We forecast the company's net profit to grow 75% YoY to HK\$146m in 16E backed by strong sales growth in Europe (from HK\$339m in 1H15 to HK\$383m in 1H16) and lower production costs due to renminbi depreciation. Additionally, this is the first full year that the company consolidates the results of Southern Cross Dental Laboratory (SCDL), an Australian distributor it fully acquired in March 2015. The acquisition has also benefited the company by giving it direct access to customers, which guarantees better pricing. We also note that the company booked a one-off expense related to its listing of c.HK\$32.6m in 15A, which also adds to the growth this year. In 17E, we forecast it to post net profit of HK\$221 (+51% YoY) on the back of organic growth and the acquisition of US-based RTFP Dental, completed in October 2016. In 1H16, the unit had posted revenue US\$33-35m.

Initiate with a BUY. We forecast EPS of HK\$0.17 in 16E (+70% YoY), HK\$0.26 in 17E (+53% YoY) and HK\$0.32 in 18E (+23% YoY). Based on a discounted cash flow (DCF) valuation, we derive a target price of HK\$4.26, representing 24.51x 16E and 16.25x 17E PE, or 1.86x 16E and 1.72x 17E PB. With 49% upside, we initiate coverage with a BUY rating.

Company at a glance

Modern Dental Group, a dental prosthetic device provider, was established in Hong Kong in 1986 and listed on the city's stock market in 2015. Its clients are located across the globe and its products include fixed and removable prosthetic devices, as well as other related products.

In order to establish a global proprietary sales and distribution network, Modern Dental has acquired many of its distributors in addition to establishing a number of arms worldwide. Its expanding sales and distribution network has made it possible for it to establish a direct relationship with customers, such as dentists, dental clinics, hospitals and distributors, and better access key markets. Currently, the company has 21 points of sale in China and 29 service centres overseas. As of end-June 2015, the company had a customer base of over 12,000 customer accounts. Its biggest market is Europe, which accounted for nearly half of its revenue in 1H16, followed by Greater China, which contributed c.25%. It also has a strong presence in North American and Australia.

Global presence

Modern Dental's biggest market is Europe, which accounted for nearly half of its revenue in 1H16, followed by Greater China, which contributed c.25%. It also has a strong presence in North American and Australia.

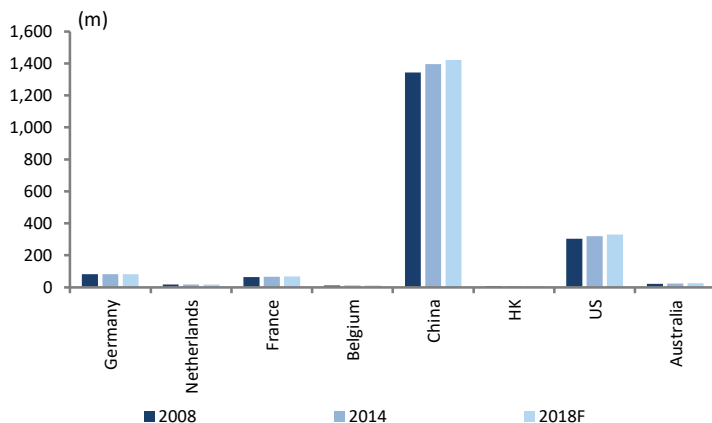
Western European market

From 2011 to 2014, the dental prosthetics market in Western Europe grew at a Cagr of 0.7%, after expanding at a Cagr of 3.6% from 2008 to 2011. Germany and France are the two biggest consumers within the regional market, which is forecasted to continue to expand at a Cagr of 0.8% from 2014 to 2018 according to Roland Berger.

The German prosthetics market, the biggest in Europe, is fueled by the population's strong oral health awareness. As one of the most developed markets, however, its expansion is expected to decelerate from a Cagr of 2.0% from 2008 to 2013 to a Cagr of 0.3% from 2014 to 2018 according to Roland Berger. Moreover, we note that the German market contracted by c.20% in 2005 as the country's public healthcare reimbursement system became limited by fixed subsidies.

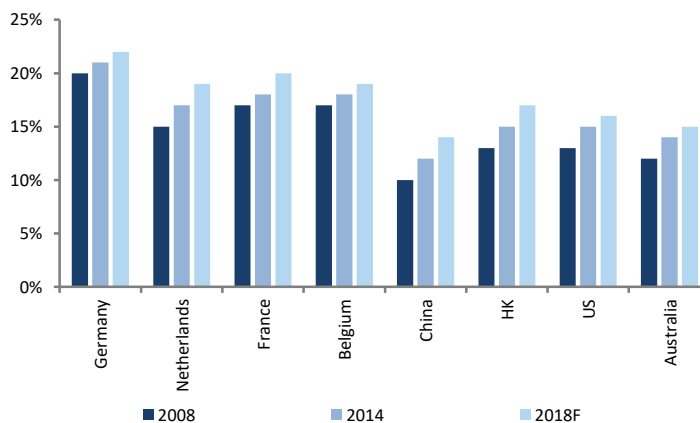
In France, c.70% of dental treatment costs are either out-of-pocket expenses or covered by private health insurers. Therefore, the country's demand for prosthetics tends to be influenced by overall economic conditions and since its population, included that of people over 65 years old, is increasing slowly, the French dental prosthetics market is not growing substantially.

Fig 1: Total population of key markets



source: Roland Berger, SWS Research

Fig 2: Percentage of population over 65 years old



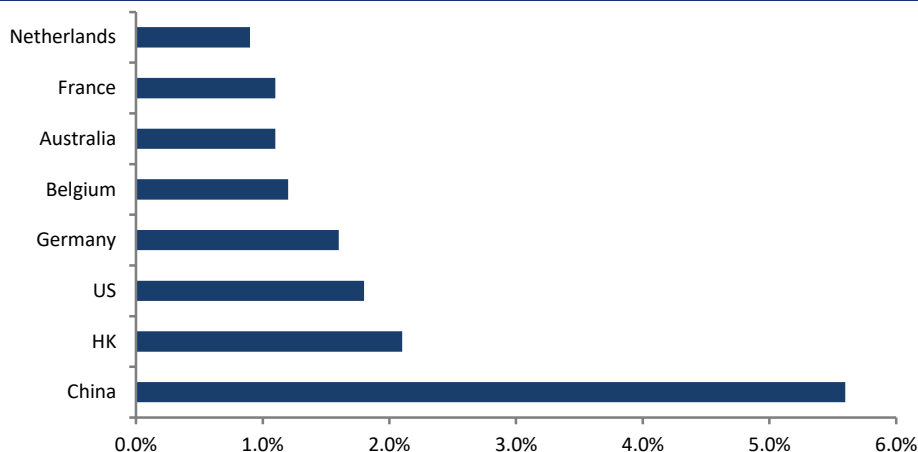
source: Roland Berger, SWS Research

Nonetheless, the populations of all of Modern Dental’s key markets have grown to some degree from 2008 to 2015. According to Roland Berger, they are likely to continue to post stable growth from 2016 to 2018. The United Nations forecasts the total population of China to expand to 1.4bn by 2018, with c.14% of it composed of individuals over 65 years old.

The Chinese market

As a result of the global financial crisis in 2008, GDP per capita in all key European markets except Germany decreased from 2008 to 2015. Meanwhile, Modern Dental highlights that China’s GDP per capita continued to expand and is expected to grow at a Cagr of 5.6% from 2014 to 2018F, representing the most rapid expansion among all of its key prosthetics markets.

Fig 3: GDP growth per capita (2014-2018F)



source: Roland Berger, SWS Research

As the living standards of the Chinese population have increased substantially over the past few years, individuals have become more conscious of oral health. As a result, the company’s market is expanding rapidly. Meanwhile, Modern Dental is able to offer high-quality products at a only slightly higher price than peers in Greater China as an increasing number of consumers turn to higher-quality products and services.

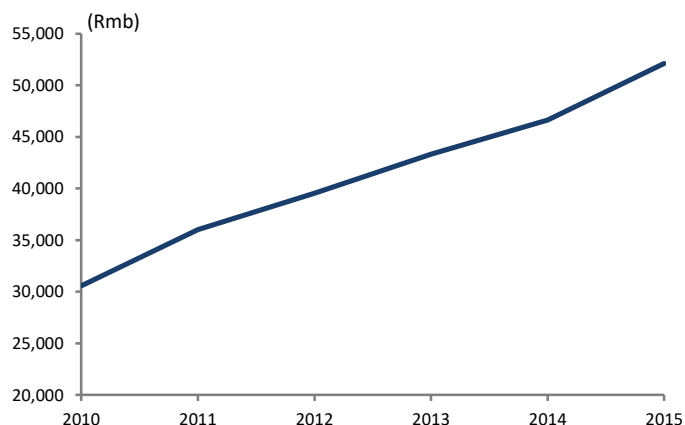
Fig 4: Average selling price by regions

HK\$	1H16	2015	2014
Europe	1,661	1,731	1,833
Greater China	677	696	660
North America	1,203	1,123	1,085
Australia	1,732	1,508	731

Others 330 405 501
 Source: Company data, SWS Research

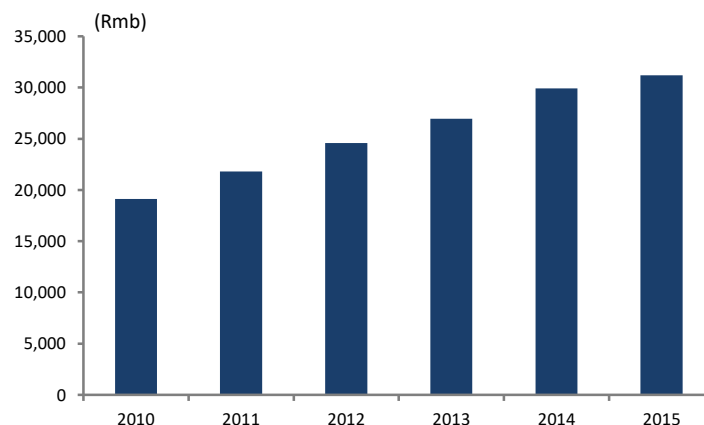
According to EDGE Intelligence, around 88% of Chinese citizens aged from 35 to 44 suffer from tooth decay currently, while the rate of repair is less than 3%, which represents a significantly higher gap compared to developed countries and indicates substantial upside for the market. A National Oral Health report shows that China's annual dental expenditure per capita in 2014 was Rmb151, and it is expected to reach Rmb198 in 2018.

Fig 5: China's GDP per capita



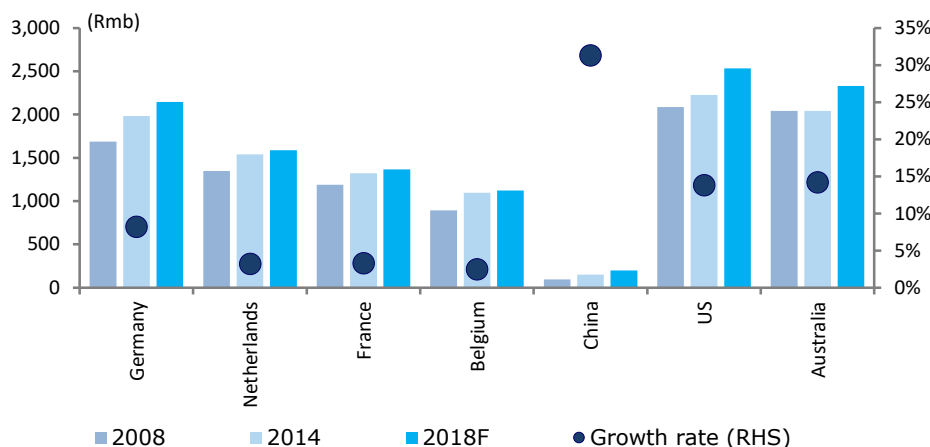
Source: NBS, SWS Research

Fig 6: Urban residents' disposable income per capita



Source: NBS, SWS Research

Fig 7: Dental expenditure per capita, by country

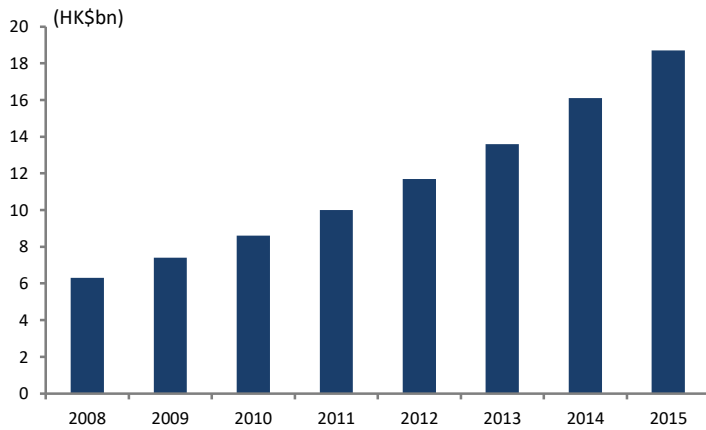


Source: Choice, SWS research

In 1H16, Greater China contributed revenue of HK\$193.23m to the company. Together with the sales of raw materials and dental equipment, which totaled HK\$1.53m, the region accounted for 25.16% of the group's total revenue in 1H16. However, we note that revenue growth in the Greater China market was partially offset by the depreciation of renminbi, with the Hong Kong market supporting stable growth.

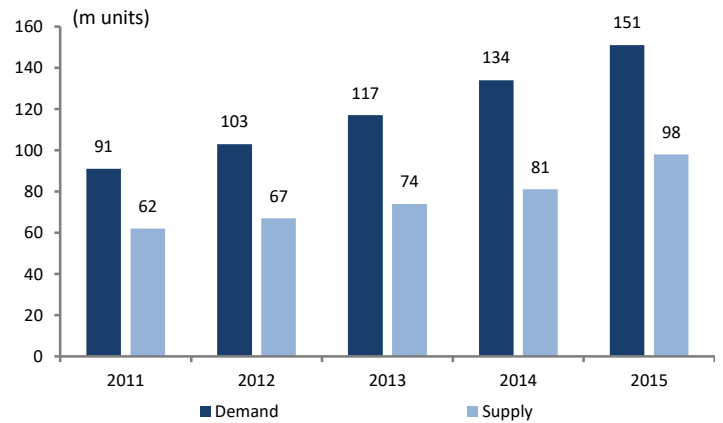
As China's population ages, the demand for prosthetics is rising rapidly. According to the EDGE Intelligence, the total size of China's dental prosthetics industry reached Rmb18.7bn in 2015, representing a five-year Cagr of c.13%. As shown in figure 9, demand currently exceeds supply in China. Customs data shows that the domestic high-end market relies heavily on imports. In 2015, China imported 0.61m and exported 26m units of dental prosthetics. The countries that export the most dentures to China are Japan (50.93%), Germany (19.17%) and Italy (11.8%). Meanwhile, as China's dental prosthetics production volume represents a high proportion of the global total, exports represent a significant amount of the country's production. Therefore, we believe there is a big potential for the domestic market.

Fig 8: China's dental prosthetics market



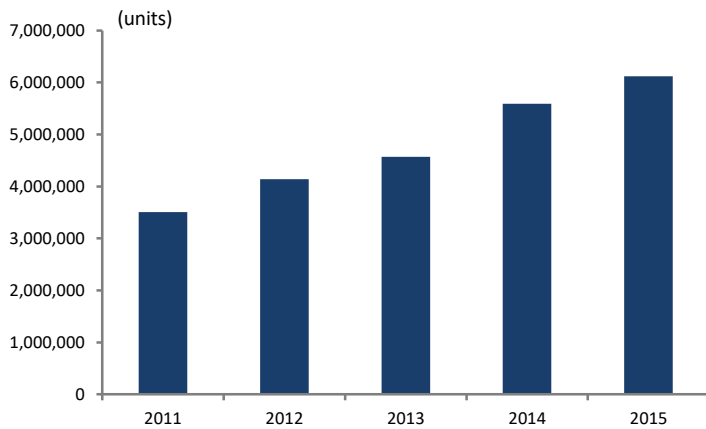
Source: EDGE Research, SWS Research

Fig 9: Demand and supply of China's dental prosthetics devices



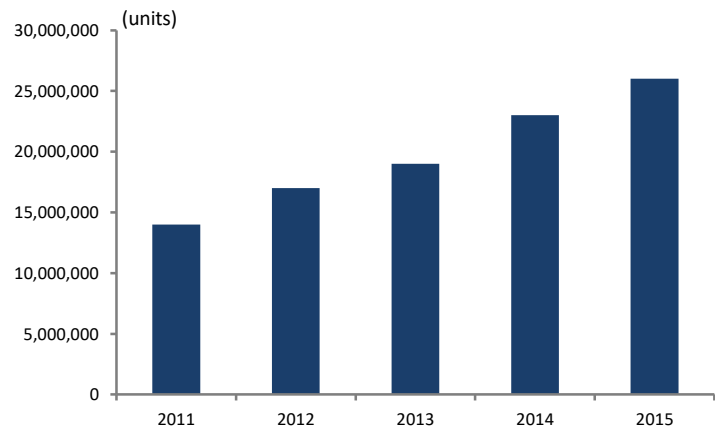
Source: EDGE Research, SWS Research

Fig 10: China's import volume



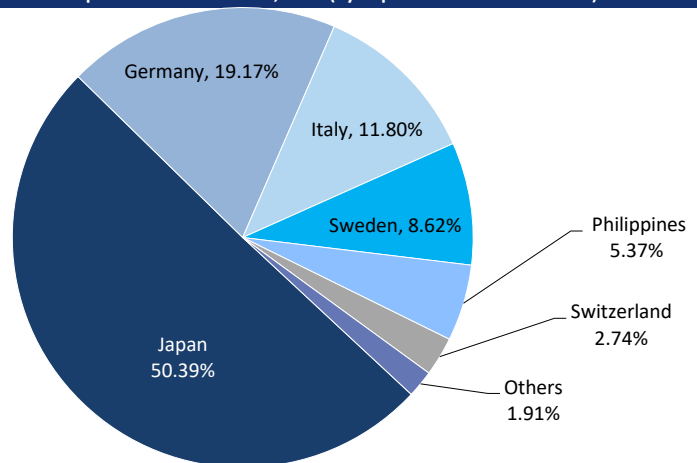
Source: EDGE Research, SWS Research

Fig 11: China's export volume



Source: EDGE Research, SWS Research

Fig 12: Distribution of countries that import dentures to China, 2015 (by imported dentures' number)



Source: EDGE Research, SWS Research

In terms of supply, we note that the industry has benefited from government support and new technologies. EDGE Intelligence foresees the total volume of China's dental prosthetics market to reach 45.6bn in 2020 on a five-year Cagr of 19.5%.

Government support

We highlight that we expect the government's push for the development of private health care institutions, as well as specialised professionals, to benefit the prosthetics market as the lack of

qualified dentists and the reluctance to adopt new technologies are currently biggest obstacles for the industry.

We also expect the government’s stricter oversight on the dental industry to result in positive changes. For instance, processing enterprises must obtain a medical device manufacturing enterprise license and an oral denture medical device production registration certificate since 2009, which, by lifting quality, is likely to improve demand.

Advanced technologies

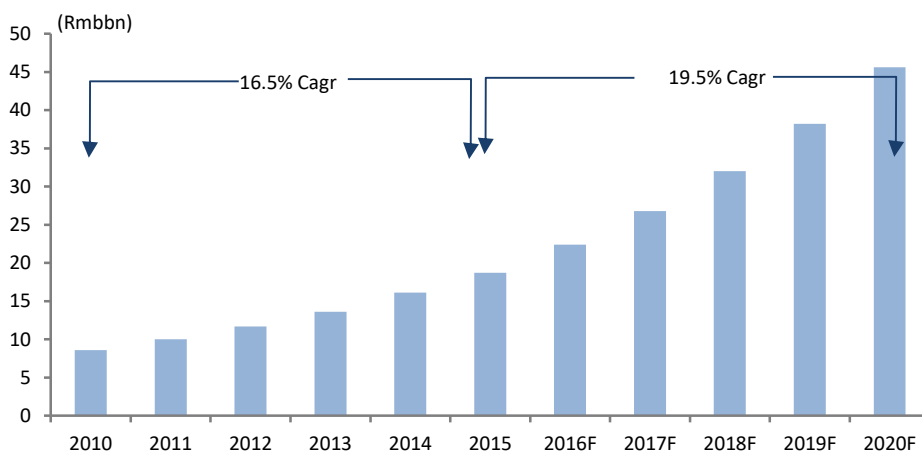
The introduction of digital production technology has improved the production efficiency and reduced costs of prosthetics processing enterprises. We expect oral digital scanning and three-dimensional (3D) printing technologies to revolutionise the industry’s business model. The 3D coloured oral scanning technology, for instance, solves colour distortion issues, while 3D printing allows companies to produce dentures within one to two hours.

Fig 13: Traditional vs digital factories

Features	Advantages	Disadvantages
<ul style="list-style-type: none"> Traditional factory <ul style="list-style-type: none"> Manufacturing uses traditional technology with low precision, requiring many subsequent manual modifications Production relies on skilled workers, but not a standard production line Dentists and technician communicate directly 	<ul style="list-style-type: none"> Low investment Low access threshold 	<ul style="list-style-type: none"> Low production efficiency High labour costs Low product accuracy Too dependent on experienced technicians
<ul style="list-style-type: none"> Digital factory <ul style="list-style-type: none"> Using CAD/CAM technology to produce high-end products and establishing production lines for non-high-end products to reduce costs Replacing gypsum with oral 3D scanning technology, which saves time and creates conditions for mass production 	<ul style="list-style-type: none"> Reduced labour costs Improving product quality Reduced production cycle 	<ul style="list-style-type: none"> High investment High access threshold

Source: SWS Research

Fig 14: China dental prosthetics market

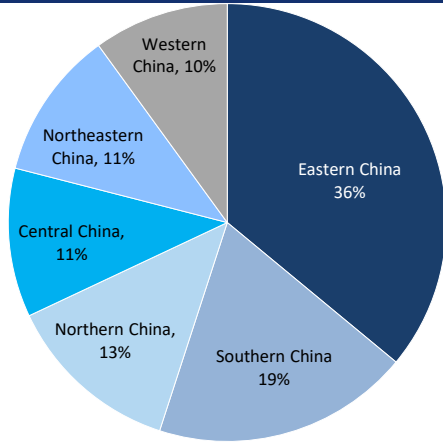


Source: EDGE Research, SWS Research

Regional breakdown

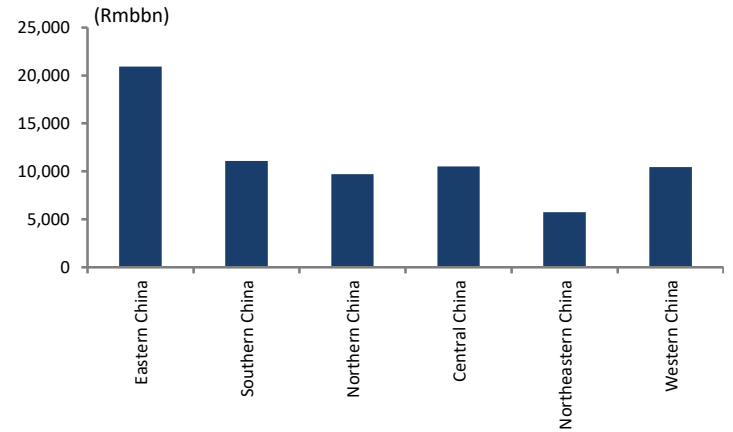
Shanghai, Shenzhen and Beijing are China’s three major dental prosthetics consumers, with the country’s main regional dental prosthetics markets being eastern China (including Shanghai), southern China (including Shenzhen) and northern China (including Beijing). Each region’s denture consumption level is proportional to their economic and medical development.

Fig 15 Dental prosthetics sales by region in China, 2015



Source: NBS, SWS Research

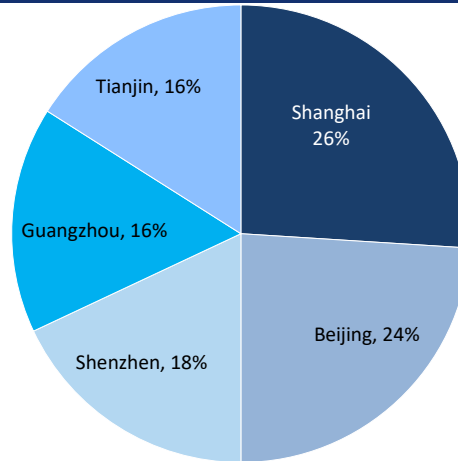
Fig 16 Regional GDP



Source: NBS, SWS Research

According to EDGE Intelligence, eastern and southern China together accounted for 54% of China’s dental prosthetics demand, with Beijing, Shanghai, Guangzhou, Shenzhen and Tianjin taking up 13.3% of the country’s demand in 2015.

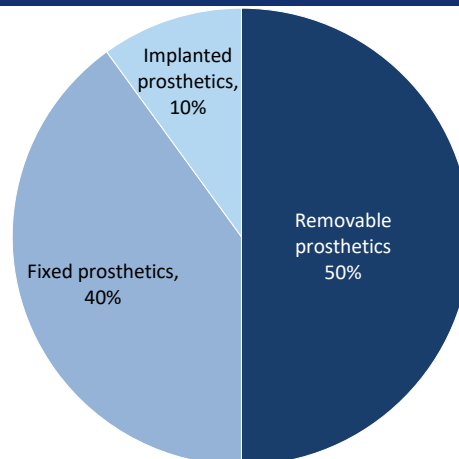
Fig 17: Domestic dental prosthetics market share of top five cities



Source: EDGE Research, SWS Research

Most prosthetics buyers are middle-aged individuals. As such, removable prosthetics account for 40-50% of the prosthetics market, while fixed prosthetics account for 30% and implanted prosthetics, 20-30%. We note that fixed prosthetics are more common among young people, who are more inclined to choose products based on appearance and convenience and thus usually have a higher tolerance for higher-priced products.

Fig 18: China denture sales volume, 2015



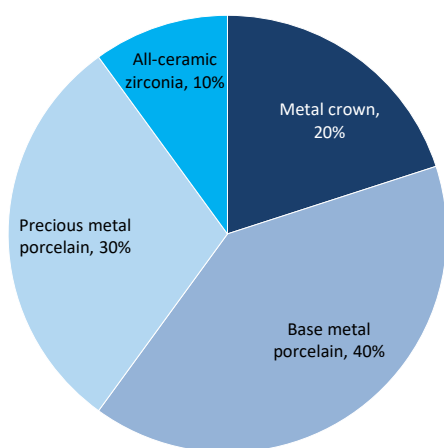
Source: EDGE Research, SWS Research

Development trend

With rising income levels and improving oral health awareness, we expect demand for base metal crown dentures to gradually contract, while that for high-quality materials increases. As such, we expect dental prosthetics products to become more expensive. We forecast metal porcelain to continue to occupy nearly half of the market share, and all-ceramic zirconia dentures to become the most popular kind.

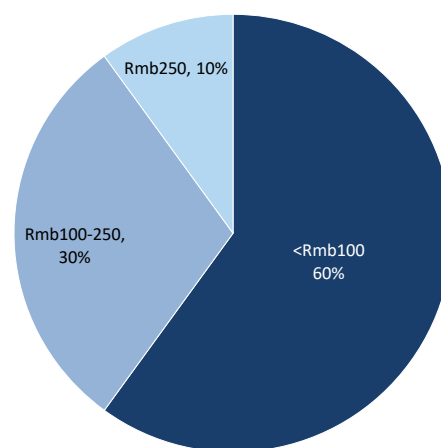
At present, low-priced (below Rmb100) metal or base metal porcelain crowns are the most widely used products. However, we believe base metal crown dentures will be scrapped in the near future as people turn to high-end products as economic conditions improve. Meanwhile, we expect the demand for middle-priced pure titanium or silver dentures to increase. High-priced whole-porcelain or implanted prosthetics take the lowest market share currently, but we believe it enjoys the most potential.

Fig 19: Prosthetic sales in China, broken down by materials, 2015



Source: EDGE Research, SWS Research

Fig 20: Price break down, 2015



Source: EDGE Research, SWS Research

Products

Modern Dental produces a variety of dental prosthetic devices, with fixed and removable prosthetic devices representing c.91.4% of its total revenue in 1H16. In addition, the firm also produces custom-made devices.

Fig 21: Product category

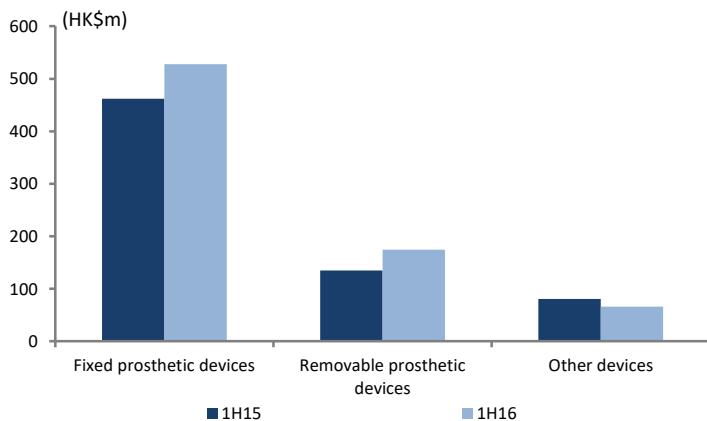
Category	Product	Description	Graph
Fixed prosthetic devices	Metal-ceramic crowns and bridges	Metal-ceramic devices have a metal structure capped in porcelain for a more natural look. The most popular type of denture	
	Metal crowns and bridges	Using a variety of alloys, from semi-precious to cheap, are usually a low-end option.	
	Metal-free crowns and bridges	Typically uses a zirconia structure covered in porcelain.	

Custom implant abutment	Typically made of titanium, ceramics or a combination.	
Removable prosthetic devices	Removable denture Replaces missing teeth.	
Other devices	Orthodontic devices Help straighten teeth and correct deformities as well as hold teeth in position.	
Sport guards	Usually custom-made.	
Anti-snoring devices	Provide patients more space to breathe.	

Source: Company, SWS Research

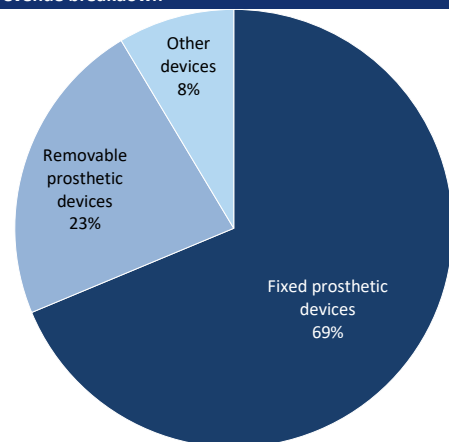
In 1H16, fixed prosthetic devices took up c.68.7% of its total revenue, while removable prosthetic devices represented 22.7%. In the future, we expect the contribution from removable prosthetic devices to go up slightly due to the aging of the population worldwide. In 1H16, for instance, the company's unit sales rose 8% YoY to c.660,000 cases.

Fig 22: Global revenue breakdown by products



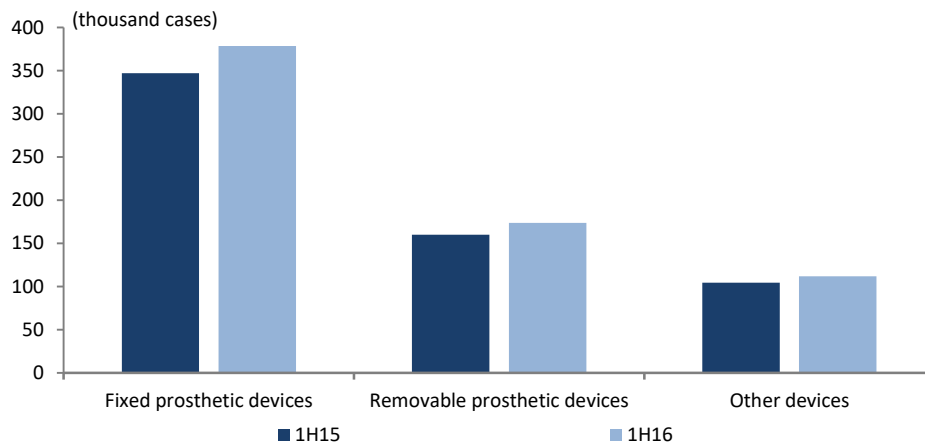
Source: Company data, SWS Research

Fig 23: 1H16 global revenue breakdown



Source: Company data, SWS Research

Fig 24: Global sales



Source: Company data, SWS Research

Brands

The global dental market is characterised by mostly small laboratories focused on local markets and is thus very fragmented. Modern Dental has been able to increase its market share through global mergers and acquisitions (M&As), while by establishing brands focused on specific markets, in each of which it emphasises quality products and superior customer service. Modern Dental’s portfolio includes Permidental and Elysee in Western Europe, Yangzijing in China, Modern Dental USA in the United States and SCDL in Australia.

Fig 25: Modern Dental brands worldwide



Source: Company data, SWS Research

Fig 26: Brands description

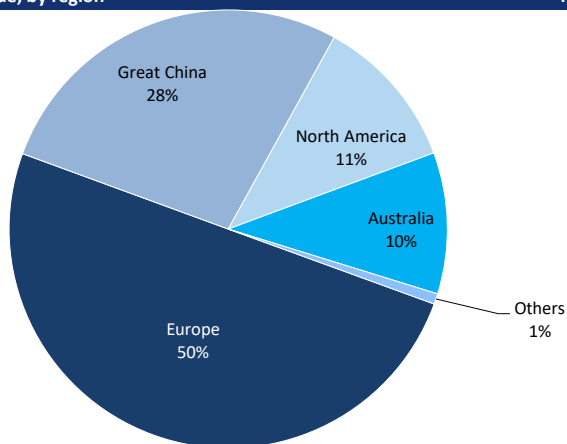
Brand Name	Logo	Time to start business under the brand	Geographic coverage	Market position
Permidental & Semperdent		The company started doing business and selling dental prosthetic devices under the brand name of "Permidental" in 2000, and started doing business and selling prosthetic devices under the name of "Permidental & Semperdent" in 2015. The company is in the process of registering this brand	Germany	Ranked third in terms of 2014 revenue in the German market, with a share of 0.4%

Elysee		2001	Netherlands, Belgium, Denmark, Norway, Switzerland, Spain, Sweden, Finland	Ranked second in terms of 2014 revenue in the Dutch market, with a market share of 6.3%, while ranking first in the Belgian market, with a market share of 2.9%
Labocast		1996	France	Ranked first in terms of 2014 revenue in the French market, with a market share of 1.2%
Modern Dental Laboratory		1986	Hong Kong	Ranked first in terms of 2014 revenue in the Hong Kong market, with a market share of 54.2%
Yangzijing		1998	Mainland China	Ranked first in terms of 2014 revenue in the Chinese market, with a market share of 1.1%
Southern Cross Dental		2000	Australia, New Zealand, Ireland	Ranked first in terms of 2014 revenue in the Australian market, with a market share of 7.1%
Andent		2013 (pending registration)	Australia	Acquired under SCDL
Gold & Ceramics		2013	Australia	Acquired under SCDL
Precision Dental		2016	New Zealand	Acquired by SCDL
Modern Dental USA		2009 (pending registration)	United States	Acquired by the company to penetrate into the fragmented US market
Sundance Dental		2014 (pending registration)	United States	Acquired by the company to penetrate into the fragmented US market
Quantum Dental		2013	Canada	Acquired by the company to penetrate into the North American market
Labo Ocean Indien		2014	France and Indian Ocean countries	Sales have grown since the acquisition
Digitel Dental		2012 (pending registration)	Hong Kong	Manufactures and sells high-precision implant parts
Microdental		2016 (pending registration)	United States, Canada	Acquired by the company to penetrate into the North American market

Source: Company data, SWS Research

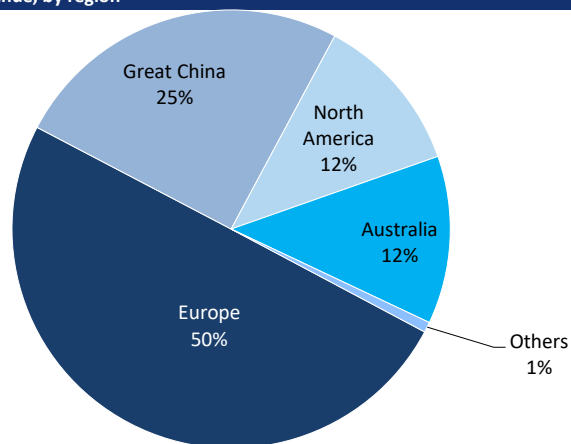
According to management, Modern Dental plans to increase its exposure to the mainland market in the coming years on the back of rising demand. Currently, most of the company's revenue stems from the European market, at 49.9% in 1H16, while China represented 25% (although the country accounted for 43% of its sales volume, at 285,341 units). Meanwhile, we also note an increasing contribution from Australia (from 5% in 2014 to 10.4% in 2015 to 12.4% in 1H16) as the company acquired SCDL in March 2015, enabling it to sell products to more retail customers at higher retailing prices.

Fig 27: 1H15 revenue, by region



Source: Company data, SWS Research

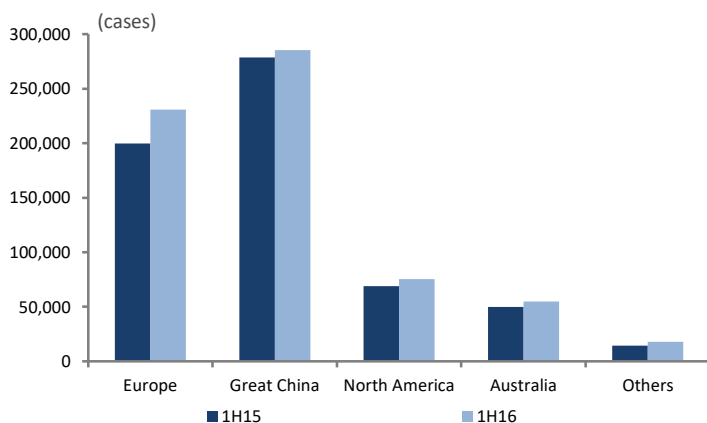
Fig 28: 1H16 revenue, by region



Source: Company data, SWS Research

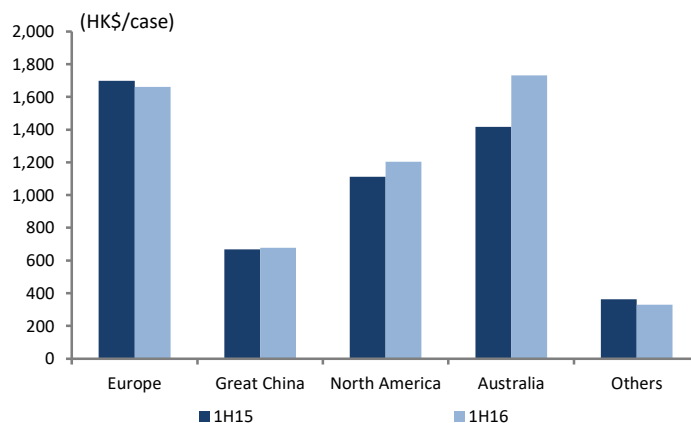
We highlight that the mismatch between the company’s sales revenue and volume is because China’s average selling price (ASP) is at HK\$677, vs the company’s blended ASP of HK\$1,157 in 1H16. We expect the country’s ASP to gradually rise as the company increasingly focuses on high value-added products. Australia’s ASP surged from HK\$1,417/case in 1H15 to HK\$1,732/case in 1H16 largely to the acquisition of SDCL.

Fig 29: Sales volume



Source: Company data, SWS Research

Fig 30: ASP



Source: Company data, SWS Research

Production

Modern Dental operates three types of production facilities. The first-tier comprises centralised production centres that focus on lower labour costs and economies of scale. These can be found in Shenzhen (over 2,800 technicians), Beijing (over 160 technicians) and Madagascar (over 190 technicians). Second-Tier facilities are regional digital production centres, which are based in the US, Germany, Hong Kong and Australia and require lower labour input and quicker turnaround time. Third tier facilities are local production facilities which are closer to end-customers and can provide custom-made solutions.

Fig 31: Production facilities

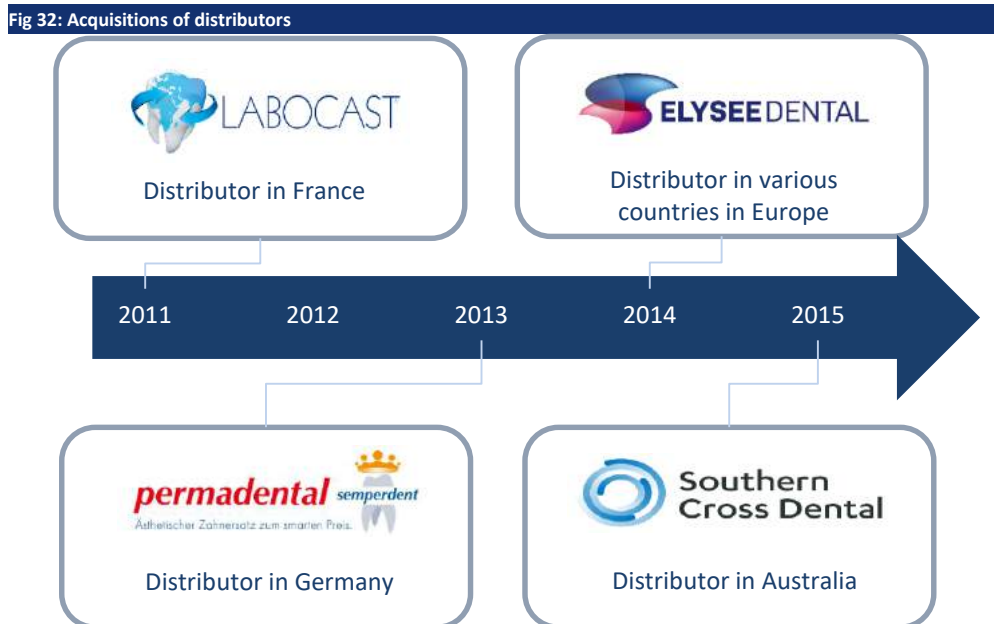


Source: Company data, SWS Research

Distribution network

Modern Dental has a global proprietary global sales and distribution network that covers over 90% of its retail customers by revenue. The company is thus able to benefit from direct access to end-customers, including dentists, dental clinics and hospitals, in key markets. By acquiring local distributors, Modern Dental has achieved a greater degree of control over distribution and gained insights into changing customer preferences, which allows it to promote products in a more targeted manner and better satisfy different customers’ needs and preferences.

Modern Dental began accelerating its acquisition plan to extend its value chain, mainly in Europe and Australia, in 2011. After acquisitions, the company adjusts branding, marketing, order taking and post-sales customer services practices in order to strengthen the acquired firms. By streamlining operations and finance functions, the company has successfully managed and integrated distributors. Management has stated that the company will continue to focus on acquisitions in Europe in 2017 after completing the acquisitions of German-based Ratiodontal and Zahnmanufaktur on 8 December 2016.



Source: Company data, SWS Research

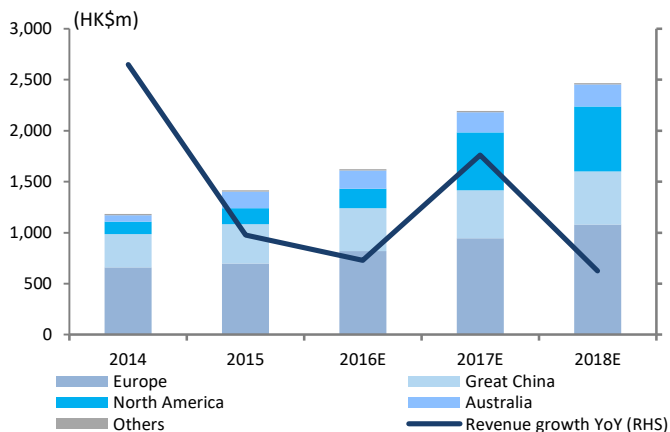
Technology

An early adopter of computer-aided design (CAD) and computer-aided manufacturing (CAM), which it has explored since 2007, Modern Dental employs advanced technologies to design prosthetic products. It has established four regional digital production centers and balanced the usage of CAD/CAM technology and manual labour to meet specific customer needs. Automated milling machines and 3D printers are also sometimes used to fabricate parts or entire products.

Financials

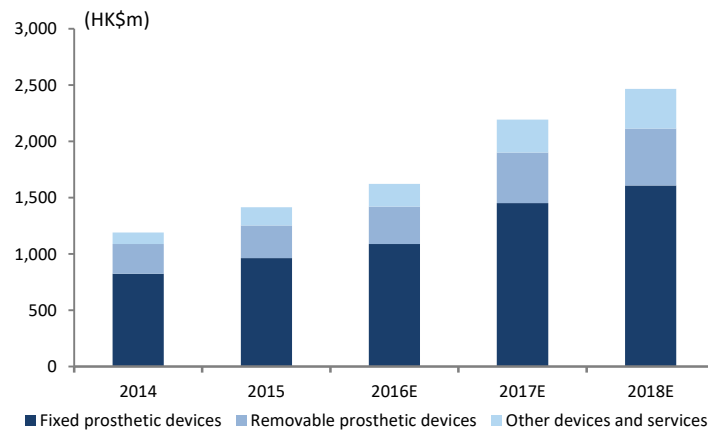
Modern Dental's revenue (excluding c.HK\$6.4m of raw materials, dental equipment and services revenue) reached HK\$768m in 1H16 (+13.4% YoY). According to management, revenue from North America grew c.15% in 9M16, while that from Greater China increased 8-9%, that from Australia rose 8-9% and that from Europe increased 10%, with total revenue expanding c.12%. In the near term, we expect most of the company's expansion, in terms of M&A and organic growth, to continue to stem from Europe. In addition, China also represents a key growth point for the company, which forecasts double-digit growth for segment in 2017 as it increases its marketing efforts in the country. Furthermore, Modern Dental completed several acquisitions in 2016, including the one related to the US-based RTFP Dental completed on 21 October 2016. RTFP Dental reported 1H16 revenue of 2016 at USD33-35m, and we conservatively estimate it to contribute revenue of c.USD60m to the company in 2017.

Fig 33: Sales forecast by region



Source: Company data, SWS Research

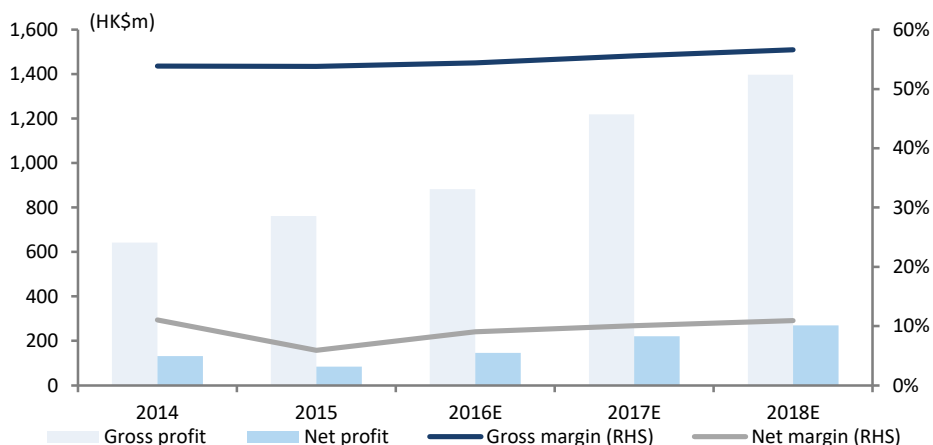
Fig 34: Sales forecast, by product



Source: Company data, SWS Research

The company's total gross profit increased 16.4% YoY to HK\$428m in 1H16 as its gross margin expanded from 53.9% in 1H15 to 55.2%, largely due to strong sales growth in Europe and the depreciation of renminbi, the major currency in which production costs are recorded.

Fig 35: Net profit forecasts



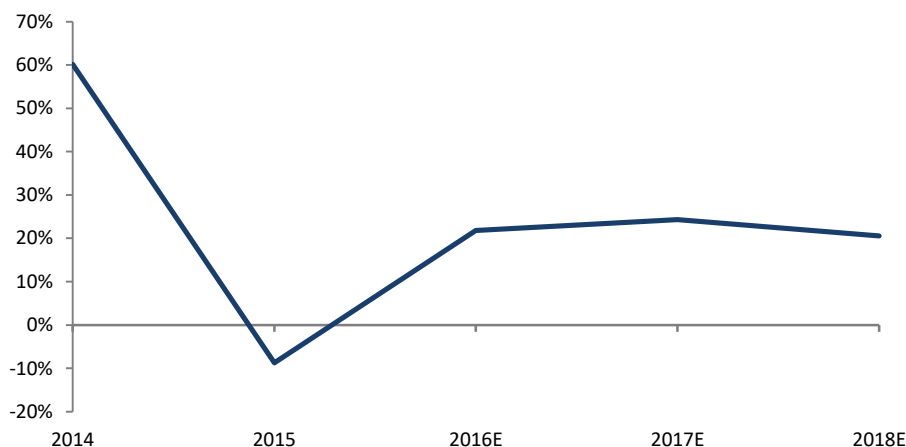
Source: Company data, SWS Research

Net profit went up c.19.6% YoY to HK\$71.1m in 1H16 as net margin improved from c.8.7% to c.9.2%. In addition to organic growth and the contribution from SCDL, the net profit increase in 1H16 was also due to the lower base from 1H15 as the company incurred listing expenses. According to management, 2017 net profit is expected to continue expanding rapidly as 2016 also saw one-off expenses of c.HK\$40m.

We expect Modern Dental's Capex to increase 680% to HK\$230m in 16E due to the expansion and modernisation of production facilities in Dongguan, Guangdong Province and the acquisition of RTFP Dental.

As the company's gearing ratio for 1H16 was c.13.2%, we believe its financial position is sound. On the back of strong cash flows, we forecast the ratio to continue decreasing over the coming years.

Fig 36: Gearing ratio



Source: Company data, SWS Research

We expect the company to see a gradual increase in trade receivables, trade payables and inventories as it expands over the next few years. Therefore, we forecast its cash conversion cycle to remain relatively stable after declining slightly in 17E, largely due to our positive expectation of the consolidation of RTFP Dental.

Fig 37: Cash conversion cycle



Source: Company data, SWS Research

Valuation

Through a discounted cash flow (DCF) model, we arrive at an equity value of HK\$3.52bn for 2016E on an enterprise value of HK\$3.83bn. We derive a weighted average cost of capital (WACC) using a risk-free rate of 3.18% (10-year government bond rate), a 10.2% market risk premium, cost of debt at 6% and an adjusted beta of 1.10 based on our assumption that the company makes no material shift in the nature of its business. Under these assumptions, we get a WACC of 12.53% and find a present value of HK\$4.26/share for Modern Dental in 16E, representing 24.51x 16E PE and 1.86x 16E PB.

Fig 38: FCF Model

FCFF model	FY16E	FY17E	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E
Revenue (HK\$m)	1,622	2,193	2,468	2,688	2,912	3,088	3,215	3,336	3,449
EBIT (HK\$m)	243	359	436	470	517	582	627	655	683
Tax paid (HK\$m)	-55	-95	-126	-126	-142	-161	-173	-183	-192
NOPAT (HK\$m)	188	264	310	344	375	421	454	472	491

Changes in WC (HK\$m)	-446	-75	-39	-28	-30	-27	-19	-17	-16
Cash NOPAT (HK\$m)	-258	188	271	316	345	394	435	456	475
Plus: D&A (HK\$m)	70	118	144	150	148	148	149	150	152
Less: Capex (HK\$m)	-234	-172	-100	-62	-67	-72	-74	-77	-81
FCFF(HK\$m)	-422	134	315	405	426	470	510	529	547
TV(HK\$m)									
Total	-422	134	315	405	426	470	510	529	547

Source: Bloomberg, SWS Research

Fig 39: WACC assumption

Risk-free Rate	3.18%	10yr China government bond
Equity Risk Premium	10.20%	Bloomberg Hong Kong market risk premium
Beta:	1.1	Bloomberg
Cost of equity	14.40%	CAPM
Nominal cost of debt	6.00%	Historical Average Data
Debt to Equity Ratio:	32%	Long-term capital structure as judged by analyst
Effective Tax Rate	29.45%	Long-term value combined with current tax rate
WACC	11.93%	

Source: SWS Research

Fig 40: DCF valuation

	2016E	2017E
EV (HK\$m)	3,833	4,712
Cash (HK\$m)	312	289
Debt (HK\$m)	627	665
Minority interest (HK\$m)	3	4
Equity value (HK\$m)	3,516	4,331
Outstanding shares	825	825
Share Price (HK\$)	4.26	5.25

Source: SWS Research

Fig 41: DCF share valuation sensitivity to assumptions of perpetual growth rate and WACC

		Perpetual growth rate							
		4.26	1.85%	1.90%	1.95%	2.00%	2.05%	2.10%	2.15%
WACC	10.43%		5.39	5.42	5.45	5.47	5.5	5.53	5.56
	10.93%		4.95	4.97	5	5.02	5.05	5.07	5.09
	11.43%		4.56	4.58	4.6	4.62	4.64	4.66	4.68
	11.93%		4.21	4.23	4.24	4.26	4.28	4.3	4.32
	12.43%		3.89	3.91	3.93	3.94	3.96	3.97	3.99
	12.93%		3.61	3.63	3.64	3.65	3.67	3.68	3.7
	13.43%		3.36	3.37	3.38	3.39	3.41	3.42	3.43

Source: SWS Research

Fig 42: Hong Kong peers

Code	Company	PE		PB	
		16F	17F	16F	17F
1509 HK	HARMONICARE MEDICAL HOLDINGS	29.3	24.9	2.1	2.0
1681 HK	CONSUN PHARMACEUTICAL GROUP	11.5	8.7	1.8	1.6
2348 HK	DAWNRAYS PHARMACEUTICAL HOLD	10.1	8.5	2.0	1.7
950 HK	LEE'S PHARMACEUTICAL HLDGS	16.3	15.0	2.2	2.0
1358 HK	PW MEDTECH GROUP LTD	12.7	10.8	1.2	1.1
1526 HK	RICI HEALTHCARE HOLDINGS LTD	7.0	18.7	2.9	2.5
3600 HK	MODERN DENTAL GROUP LTD	15.9	13.0	1.5	1.3
2120 HK	WENZHOUS KANGNING HOSPITAL -H	33.4	25.1	2.3	2.1
963 HK	BLOOMAGE BIOTECHNOLOGY	17.5	14.3	2.7	2.3
Median		15.9	14.3	2.1	2
Mean		17.1	15.4	2.1	1.8
3600 HK	MODERN DENTAL	15.9	13.0	1.5	1.3

Source: SWS Research

Fig 43: Peer table (global comparables)

Code	Company	Exchange	PE		PB	
			16F	17F	16F	17F
HSIC	HENRY SCHEIN	NASDAQ	23.1	20.9	4	3.5
XRAY	DENTSPLY SIRONA	NASDAQ	20.8	19	1.5	1.6
STMN	STRAUMANN HLDG-R	SIX	30.4	29	-	-
48260	OSSTEM IMPLANT	KOSDAQ	30.5	23.8	6	5
600763	TOPCHOICE MEDI-A	SH	50.4	53.1	11.2	10.9
QNM	Q&M DENTAL GROUP	SGX	45.3	-	5.8	-
PSQ	PACIFIC SMILES	ASX	32	-	7.4	-
Median			30.5	23.8	5.9	4.3
Mean			32.9	28.3	6	5.1
3600 HK Equity	MODERN DENTAL		15.9	13.0	1.5	1.3

Source: Bloomberg, SWS Research

Comparing Modern Dental with peers in Hong Kong and globally, we find that the company is undervalued in terms of both its PE and PB ratios. Thus, due to its robust cash flows and rapid business growth worldwide, we expect the company to outperform other health care plays. Our target price implies 49% upside and we initiate coverage with a BUY rating.

Appendix

Fig 44: Management team

Name	Position	Summary
Chan Kwun Fung	Chairman	Chan Kwun Fung is a dental technician and has over 30 years of experience in dental prosthetics. He became a director in 2012 and an executive director and the chairman of the board in 2015.
Chan Kwun Pan	Vice-chairman	Chan Kwun Pan has been certified in dental mechanics for over 40 years and is an executive director and the vice chairman of the board since 2015, after being a director since 2012.
Ngai Shing Kin	CEO	Ngai Shing Kin has over 49 years of experience in dental prosthetics and is Modern Dental's chief executive officer since 2015. He joined MDLCL in 1996 as a director, became Modern Dental's director in 2012 and is an executive director since 2015, in addition to being a member of the company's nomination committee
Ngai Chi Ho Alwin	COO	Ngai Chi Ho Alwin initially joined MDLCL in February 2006 as an information technology manager and is now Modern Dental's chief operating officer since 2015. He became a director in 2014 and an executive director in 2015, while serving as a member of the company's remuneration committee.
Cheung Ting Pong	CFO and company secretary	Cheung Ting Pong has over 13 years of experience in financial operations and has worked with Modern Dental since 2011, when it joined MDLCL as its chief financial officer. He is Modern Dental's chief financial officer since 2015 in addition to serving as its director and company secretary since 2014 and as executive director since 2015.
Chan Chi Yuen	Executive director and COO of YZJSZ	Chan Chi Yuen joined YZJSZ as its chief operating officer in 2011. He became Modern Health's director in 2014 and executive director in 2015.
Chan Ronald Yik Long	Executive director and general manager of MDLCL	Chan Ronald Yik Long is a registered dentist in Hong Kong and joined Modern Dental in 2014. He became a director on that year and an executive director in 2015, and currently serves in its nomination committee.
Chan Yik Yu	CMO	Chan Yik Yu has over five years of experience in marketing and is the chief marketing officer of Modern Dental, which joined in 2014. She is its director since 2014 and executive director since 2015 and also serves in the company's remuneration committee.
Cheung Wai Bun Charles	Independent non-executive director	Cheung Wai Bun Charles has held senior management positions in various industries and is an independent non-executive director since 2015. He is the chairman of Modern Dental's audit committee and a member of the nomination committee.
Chan Yue Kwong Michael	Independent non-executive director	Chan Yue Kwong Michael is an independent non-executive director since 2015, serving as the chairman of Modern Dental's nomination committee and a member of its audit and remuneration committees.
Wong Ho Ching	Independent non-executive director	Wong Ho Ching became Modern Dental's independent non-executive director in 2015 and serves as the chairman of its remuneration committee and as a member of its audit committee.
Cheung Wai Man William	Independent non-executive director	Cheung Wai Man William is a dentist and an independent non-executive director since 2015, serving in the nomination and remuneration committees.

Source: SWS Research

Fig 45: Senior Management of subsidiary

Name	Position	Summary
August Schwafert	CEO of Europe Holding Netherlands	August Schwafert has over 25 years of management experience in the dental industry and joined Modern Dental as the chief executive officer of its subsidiary Europe Holding Netherlands in 2014. He is responsible for the company's business development in Europe.
Gregory Scialom	President of Labocast	Gregory Scialom is the president of Labocast, which was fully acquired by Modern Dental in 2014, since 2011. He is responsible for Modern Dental's business in France and Indian Ocean.
Christopher Aughton	CEO of SCDL	Christopher Aughton has over 15 years of experience in finance and information technology and joined SCDL, which Modern Dental acquired in 2015, as its chief operating officer in 2012, becoming its chief executive officer in 2013. He oversees Modern Dental operations in Australia, New Zealand and Ireland.

Source: SWS Research

Fig 46: Consolidated Income Statement

HK\$m	2014	2015	2016E	2017E	2018E	2019E
Revenue	1,192	1,416	1,622	2,193	2,468	2,688
Cost of Sales	-550	-654	-740	-975	-1,070	-1,170
Gross Profit	642	761	882	1,219	1,397	1,519
Other Income	20	3	3	3	3	3
Distribution and marketing costs	-138	-148	-167	-220	-242	-264
Administrative expenses	-313	-434	-469	-634	-714	-778
EBITDA	259	242	313	477	580	621
EBIT	206	178	243	359	436	470
Finance Costs	-30	-42	-42	-43	-40	-46
Profit before tax	176	135	201	316	396	424
Income tax expense	-44	-52	-55	-95	-126	-126
Minority interests	11	1	3	4	5	6

Profit attributable	120	82	143	216	265	292
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Source: SWS Research

Fig 47: Consolidated Cash Flow Statement

HK\$m	2014	2015	2016E	2017E	2018E	2019E
Profit before taxation	176	135	201	316	396	424
Plus : Depr. and amortisation	52	65	70	118	144	150
Finance cost	30	42	42	43	40	46
Losses from investments	3	18	0	0	0	0
Change in working capital	-26	-91	-446	-75	-39	-28
Others	-54	-48	-55	-95	-126	-126
CF from operating activities	181	122	-188	307	414	467
CAPEX	-18	-30	-234	-172	-100	-62
Other CF from investing activities	-332	-236	-108	-88	-90	-89
CF from investing activities	-351	-266	-342	-261	-189	-151
Equity financing	0	797	0	0	0	0
Net change in liabilities	219	311	-19	38	-80	156
Dividend and interest paid	-38	-54	-85	-108	-119	-133
Other CF from financing activities	-2	-97	0	0	0	0
CF from financing activities	179	956	-104	-70	-200	23
Net cash flow	10	811	-633	-24	25	339

Source: SWS Research

Fig 48: Consolidated Balance Sheet

HK\$m	2014	2015	2016E	2017E	2018E	2019E
Current Assets	626	1,336	765	882	973	1,368
Bank balances and cash	168	946	312	289	314	653
Trade and other receivables	278	320	362	478	534	579
Inventories	58	58	78	103	113	124
Other current assets	123	12	12	12	12	12
PP&E	138	138	344	448	458	428
Intangible and other assets	868	1,205	1,708	1,747	1,783	1,813
Total Assets	1,632	2,679	2,817	3,077	3,214	3,609
Current Liabilities	424	300	420	459	485	541
Borrowings	136	102	169	142	141	169
Trade and other payables	206	154	208	273	300	328
Other current liabilities	82	44	44	44	44	44
Long-term liabilities	657	591	506	571	492	620
Total Liabilities	1,081	892	926	1,030	977	1,161
Minority Interests	7	8	11	16	21	27
Shareholder Equity	544	1,780	1,880	2,031	2,216	2,421
Share Capital	40	78	78	78	78	78
Reserves	504	1,703	1,803	1,954	2,140	2,344
Equity attributable	544	1,780	1,880	2,031	2,216	2,421
Total Liabilities and equity	1,632	2,679	2,817	3,077	3,214	3,609

Source: SWS Research

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