Deutsche Bank
Markets Research

Rating
Buy

Asia
China

Health Care
Health Care

Company
Aier Eye Hospital

Reuters	Bloomberg	Exchange	Ticker
300015.SZ	300015 CH	SHZ	300015

Date
31 October 2017

Forecast Change

Price at 31 Oct 2017 (CNY)	27.68
Price target - 12mth (CNY)	31.60
52-week range (CNY)	34.16 - 21.20
Shenzhen Index	2,080

Valuation & Risks

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Key changes

TP	28.70 to 31.60	↑	10.1%
Sales (FYE)	5,439 to 5,779	↑	6.3%
Op prof margin (FYE)	-	↑	0.1%
Net profit (FYE)	749.1 to 731.5	↓	-2.4%

Source: Deutsche Bank

Price/price relative

Performance (%)	1m	3m	12m
Absolute	9.3	22.5	-18.2
Shenzhen Index	0.0	5.8	-3.0

Source: Deutsche Bank

Strong quarter driven by both organic growth and acquired assets

Growth acceleration continued in 3Q

Aier reported revenue/core profit of RMB1.8bn/292m in 3Q17, representing YoY growth of 54%/45% respectively, vs. 35%/34% in 1H17, and vs. 26%/19% for revenue/core profit in 2016. The company commented that organic growth of revenue and core profit was 28%/38% in 3Q17, vs. 31%/ 27% in 2Q17, and vs. 24%/ 22% in 1Q17. Management attributes the robust revenue growth to consolidation of newly-acquired subsidiaries (including Clinica Baviera) and organic growth of existing hospitals. We expect further growth acceleration, driven by contribution from new assets and solid existing business. We reiterate Buy on high earnings sustainability and visibility.

Strong growth momentum for the three major segments

Sales growth of excimer surgery, cataract surgery, and optometry was estimated to be 50%, 57%, and 37% in 3Q17, vs. 42%, 33%, and 30% in 1H17, and vs. 36%, 22%, and 37% in 2016, respectively. We believe the strong results were owing to the growing need for ophthalmic services in China. On M&A, the Clinica Baviera deal closed in August 2017 and is expected to add another leg of growth in 4Q17.

Margin improved in 3Q17

GM/OPM registered 50.6% and 25.4%, respectively, in 3Q17, vs. 48.5% and 22.1% in 3Q16. We attribute the margin expansion to the ramp-up of new hospitals, economies of scale, and lower admin costs. We also highlight that finance costs advanced 1324% YoY in 3Q17, resulting from a large amount of borrowings for acquisitions. We believe the momentum in operating margin improvement will continue with the contribution from new assets.

Increasing price target to RMB32.4 from RMB28.7; risks

Our target price is based on 26x EV/EBITDA of 2018E EBITDA, vs. the 25x we used previously, due to sector re-rating. We believe 26x is justified, as its Asia-listed peers are trading at 19x with 6% EBITDA growth in 2019E (vs. the 25% we model for Aier). Key risks include delays in geographical expansion, execution risk related to newly-acquired business, and slower ASP/ volume growth.

Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	3,165.6	4,000.4	5,779.4	8,014.2	10,018.0
EBITDA (CNYm)	788.4	915.4	1,300.9	1,794.4	2,220.5
EV/EBITDA (x)	53.2	52.3	30.7	22.1	17.6

Source: Deutsche Bank estimates, company data

Takeaways from dbAccess China Healthcare Corporate Day

We hosted Aier management on Friday, with the following key updates:

- Hospital network: The company is well on track to reach the 200 hospital target by YE17. As of Sep 2017, Aier has over 190 facilities under its umbrella, with 78 consolidated in the listed company. Among the 78 hospitals, only 10 are loss-making, while the majority in the M&A fund are not yet profitable. Management expects to include another batch from the M&A fund once they reached operational targets.
- The partnership incentive program launched in 2014 was well structured, as the break-even period shortened for newly-established hospitals. Notably, prefecture level hospitals, if well managed, could break even in year 1, record significant profit in year 2, then develop into a mature hospital by year 3, while in general, it may take 2-3 years to break even and record profits. Management estimated 8-10 more hospitals to reach the 100m revenue scale, compared with nine hospitals by YE16.
- Growth acceleration was achieved for all major segments in 3Q17. We highlight that cataract surgery posted highest growth with 57% in 3Q17, vs. 33% in 1H17. Excimer and posteria segment surgery also performed well, registering 51%/ 48% in 3Q17, compared to 41% and 36% in 1H17.
- On growth, the company maintained guidance of 30% in the mid term, via both organic growth and acquisitions. For existing hospitals, mature ones such as Wuhan, Changsha could continue at 15% growth, or closer to 20% for small-base hospitals. Profit growth from these hospitals can be over 20% YoY.
- Aier will continue to review the opportunity for expanding its international footprint and building synergies. The ideal collaboration will enable Aier to export its products, while, in reverse, importing innovation/ technology into the home market, thereby defending its bellwether status.
- On geographical expansion, the company achieved decent results in coastal tier 1 and 2 cities, especially for cities like Shenzhen, which has a high percentage of migrant workers and incoming population. On the contrary, Northern cities including Taiyuan are showing slower-than-expected growth, on the back of barriers for promotion and patients/ physician education.
- On ASP, Aier has not raised the ASP of individual surgery. However, the company is witnessing a shift from low-ASP to high-ASP patient choice, primarily in tier 1/2 cities. Aier believes the service mix change could offer further margin expansion opportunity for the China business.
- For acquired overseas business: the US AW Vision contributed RMB26m sales in 3Q, with approximately RMB6m of net profit. We believe CB might have generated a loss for the company.

Model updated: 31 October 2017

Running the numbers

Asia

China

Health Care

Aier Eye Hospital

Reuters: 300015.SZ Bloomberg: 300015 CH

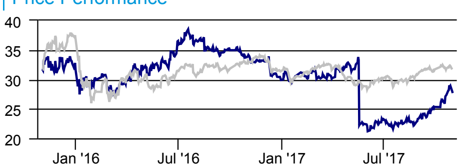
Buy

Price (31 Oct 17)	CNY 27.68
Target Price	CNY 31.60
52 Week range	CNY 21.20 - 34.16
Market cap (m)	CNYm 42,117 USDm 6,333.3

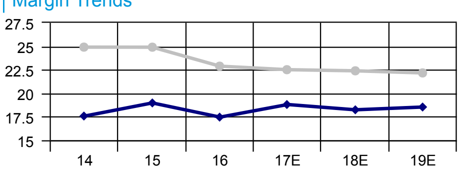
Company Profile

Aier Eye Hospital Group Co., Ltd. is a China-based ophthalmonogy medical institution. The company's services include ophthalmocace diagnosis, ophthalmocace treatment, pharmaceuticals distribution and medical optometry. The company provides excimer operations, cataract operations, anterior segment operations, and posterior segment operations and examinations.

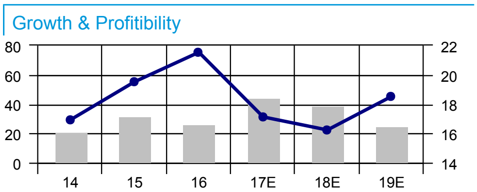
Price Performance



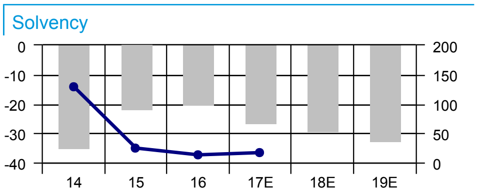
Margin Trends



Growth & Profitibility



Solvency



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Fiscal year end 31-Dec	2014	2015	2016	2017E	2018E	2019E
Financial Summary						
DB EPS (CNY)	0.21	0.31	0.36	0.50	0.67	0.87
Reported EPS (CNY)	0.21	0.29	0.37	0.48	0.66	0.85
DPS (CNY)	0.04	0.07	0.09	0.12	0.15	0.21
BVPS (CNY)	1.3	1.6	1.9	3.8	4.3	4.9
Weighted average shares (m)	1,478	1,478	1,501	1,520	1,522	1,522
Average market cap (CNYm)	24,553	42,646	49,066	42,117	42,117	42,117
Enterprise value (CNYm)	23,785	41,942	47,831	39,945	39,597	39,092
Valuation Metrics						
P/E (DB) (x)	77.7	92.7	89.7	55.3	41.5	32.0
P/E (Reported) (x)	79.4	99.6	88.0	57.5	42.2	32.4
P/BV (x)	13.62	19.49	16.13	7.30	6.46	5.61
FCF Yield (%)	1.1	0.6	0.7	1.1	1.5	2.1
Dividend Yield (%)	0.3	0.2	0.3	0.4	0.6	0.8
EV/Sales (x)	9.9	13.2	12.0	6.9	4.9	3.9
EV/EBITDA (x)	39.8	53.2	52.3	30.7	22.1	17.6
EV/EBIT (x)	56.3	69.8	68.5	36.8	27.1	21.1
Income Statement (CNYm)						
Sales revenue	2,402	3,166	4,000	5,779	8,014	10,018
Gross profit	1,079	1,475	1,845	2,693	3,698	4,650
EBITDA	598	788	915	1,301	1,794	2,220
Depreciation	114	122	141	131	269	316
Amortisation	62	66	76	83	63	48
EBIT	422	601	699	1,087	1,462	1,857
Net interest income(expense)	4	4	-5	-44	-111	-110
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	3	-4	7	-18	0	0
Other pre-tax income/(expense)	-22	-51	-16	-40	-72	-90
Profit before tax	407	550	684	984	1,279	1,657
Income tax expense	94	114	117	186	229	297
Minorities	4	9	10	67	52	61
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	309	428	557	731	997	1,299
DB adjustments (including dilution)	7	32	-11	29	17	17
DB Net profit	316	460	547	760	1,014	1,316
Cash Flow (CNYm)						
Cash flow from operations	454	522	675	977	1,356	1,687
Net Capex	-177	-261	-314	-520	-721	-801
Free cash flow	277	261	361	457	634	885
Equity raised/(bought back)	0	0	0	2,427	0	0
Dividends paid	-70	-105	-312	-178	-234	-319
Net inc/(dec) in borrowings	0	174	0	1,000	0	0
Other investing/financing cash flows	-106	-396	6	-1,703	0	0
Net cash flow	101	-66	55	2,003	400	566
Change in working capital	-37	-116	-106	-35	-26	-38
Balance Sheet (CNYm)						
Cash and other liquid assets	720	721	776	2,779	3,179	3,745
Tangible fixed assets	575	646	769	1,584	2,036	2,522
Goodwill/intangible assets	265	465	471	1,747	1,745	1,743
Associates/investments	120	264	803	803	803	803
Other assets	871	1,160	1,246	1,481	1,612	1,820
Total assets	2,550	3,257	4,066	8,394	9,376	10,634
Interest bearing debt	0	177	188	1,188	1,188	1,188
Other liabilities	489	581	941	1,222	1,388	1,605
Total liabilities	489	757	1,129	2,410	2,576	2,793
Shareholders' equity	1,988	2,395	2,781	5,761	6,524	7,505
Minorities	73	104	156	222	275	336
Total shareholders' equity	2,061	2,499	2,937	5,984	6,799	7,841
Net debt	-720	-544	-588	-1,591	-1,991	-2,557
Key Company Metrics						
Sales growth (%)	21.0	31.8	26.4	44.5	38.7	25.0
DB EPS growth (%)	33.8	45.5	17.1	37.3	33.3	29.8
EBITDA Margin (%)	24.9	24.9	22.9	22.5	22.4	22.2
EBIT Margin (%)	17.6	19.0	17.5	18.8	18.2	18.5
Payout ratio (%)	20.7	22.9	24.6	24.4	23.5	24.6
ROE (%)	16.9	19.5	21.5	17.1	16.2	18.5
Capex/sales (%)	7.4	8.2	7.9	9.0	9.0	8.0
Capex/depreciation (x)	1.0	1.4	1.5	2.4	2.2	2.2
Net debt/equity (%)	-34.9	-21.8	-20.0	-26.6	-29.3	-32.6
Net interest cover (x)	nm	nm	129.3	24.6	13.1	17.0

Source: Company data, Deutsche Securities estimates

Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Aier Eye Hospital	300015.SZ	27.68 (CNY) 31 Oct 2017	NA

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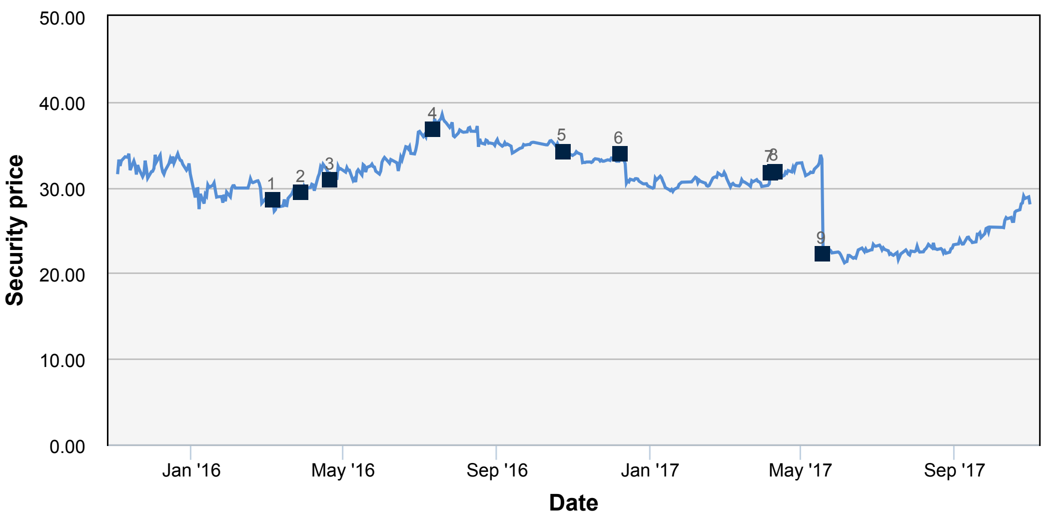
Historical recommendations and target price. Aier Eye Hospital (300015.SZ)

(as of 10/31/2017)



Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	03/06/2016	Buy, Target Price Change CNY 33,00 Jack Hu, Ph.D
2.	03/29/2016	Buy, Target Price Change CNY 34,00 Jack Hu, Ph.D
3.	04/21/2016	Buy, Target Price Change CNY 36,00 Jack Hu, Ph.D
4.	07/12/2016	Buy, Target Price Change CNY 39,50 Jack Hu, Ph.D
5.	10/24/2016	Buy, Target Price Change CNY 39,00 Jack Hu, Ph.D
6.	12/08/2016	Buy, Target Price Change CNY 42,00 Jack Hu, Ph.D
7.	04/07/2017	Buy, Target Price Change CNY 41,00 Jack Hu, Ph.D
8.	04/11/2017	Buy, Target Price Change CNY 43,00 Jack Hu, Ph.D
9.	05/19/2017	Buy, Target Price Change CNY 28,70 Linc Yiu**

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Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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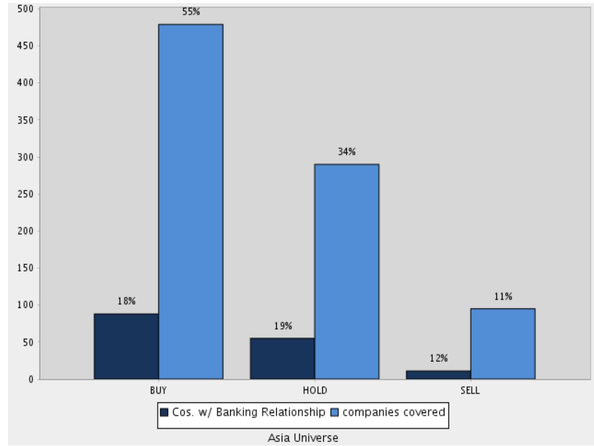
Equity rating dispersion and banking relationships



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