

AK Medical (1789 HK)

Accelerating import substitution; positive outlook of 2023E

AK Medical reported a positive profit alert for FY22E, expecting revenue to increase by over 35% YoY and net profit attributable to shareholders to increase by over 100% YoY, both of which are largely in line with the consensus estimates.

- **Strong demand of AK Medical's products after the implementation of joint VBP.** The revenue growth in FY22E was primarily driven by the strong demand of artificial joints. As a big winner in the national joint VBP, AK Medical has been allocated approximately 81,000 pieces, which ranked first among all brands. Besides, distributors are reluctant to sell imported products since the VBP narrowed the price gap between imported and domestic products, cutting much room for profit for distributors. Therefore, we expect the import substitution in 2023E would continue to accelerate, enabling AK Medical to constantly gain share from MNCs.
- **Expectation on rapid recovery of surgery volume in 2023E.** The outbreak of COVID-19 in late 2022 negatively impacted the surgery volume of the orthopedic implant as large amounts of medical resources were directed to COVID-19 patients and thereby slowing AK Medical's revenue growth in 2H22. However, the orthopedic surgery demand was postponed rather than canceled, which would be deferred to the following year. We expect a quick recovery of China's orthopedic implant market in 2023E as COVID-19 has subsided and the price reduction after VBP will also help to improve implant demand.
- **3D-printed products as the next growth engine for AK Medical.** 3D-printed products, such as ICOS customized products, are safe from VBP and have higher profit margins. The national orthopedic VBP provided the Company with valuable opportunities to introduce its high-margin products to more hospitals since the Company successfully expanded its hospital coverage to a total of 3,497 hospitals and increased its channel penetration in Class III hospitals after the implementation of joint VBP. Since they met the needs of a differentiated market, we expect the 3D-printed products to offer further upside potential in the future. Additionally, AK Medical has extended its business to the digital intelligent orthopedic and other fields such as biomaterials segment and oral prosthetics. In late 2022 and early 2023, its navigation system for hip replacement implant surgery and dental implant system were approved by NMPA, enhancing its future competency.
- **Maintain BUY.** We believe the VBP would drive AK Medical's solid growth and the long term share gains. We expect its revenue growth at a CAGR of 29.6% from 2023E to 2025E and raise our TP from HK\$9.20 to HK\$11.44 based on a 9-year DCF model (WACC: 9.54%, terminal growth rate: 3.0%).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	1,035	761	1,065	1,444	1,900
YoY growth (%)	11.7	(26.5)	39.9	35.5	31.6
Net profit (RMB mn)	314	93	193	273	377
YoY growth (%)	17.6	(70.5)	108.7	41.1	38.1
EPS (Reported) (RMB cents)	28.5	8.3	17.3	24.5	33.8
YoY growth (%)	11.0	(70.8)	108.1	41.1	38.1
P/E (x)	58.0	106.3	43.5	30.8	22.3
Yield (%)	0.2	0.2	0.5	0.6	0.9
ROE (%)	19.9	4.5	9.2	11.9	14.7
Net gearing (%)	(36.3)	(26.9)	(36.5)	(35.2)	(34.5)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$11.44**

(Previous TP) **HK\$9.20**

Up/Downside **17.04%**

Current Price **HK\$9.77**

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Stock Data

Mkt Cap (HK\$ mn)	9,628.9
Avg 3 mths t/o (HK\$ mn)	8.8
52w High/Low (HK\$)	10.30/3.60
Total Issued Shares (mn)	1115.8

Source: FactSet

Shareholding Structure

Ximalaya Limited	45.3%
Gaoling Fund	6.4%

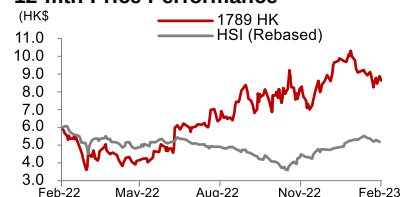
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-14.4%	-10.5%
3-mth	4.5%	-7.9%
6-mth	33.2%	28.2%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Valuation of peers

Ticker	Company name	Mkt cap (HKD mn/RMB mn)	22E PE	23E PE	22E PS	23E PS
6699 HK	Angelalign Technology Inc	20,594	83.3	62.9	14.7	11.9
1858 HK	Beijing Chunlizhengda Medi-H	12,974	21.2	18.0	9.3	7.4
6669 HK	Acotec Scientific Holdings L	5,973	79.3	48.5	15.0	10.3
6606 HK	New Horizon Health Ltd	14,893	#N/A	#N/A	18.6	10.0
002901 CH	Double Medical Technology-A	15,572	21.2	17.9	#N/A	#N/A
688236 CH	Beijing Chunlizhengda Medi-A	11,361	38.4	30.9	9.3	7.0
688085 CH	Shanghai Sanyou Medical Co-A	6,561	30.7	24.6	9.0	7.1
688161 CH	Shandong Weigao Orthopaedi-A	27,356	32.6	26.3	10.3	8.3
688617 CH	Apt Medical Inc-A	23,417	70.8	52.4	18.8	13.6
300633 CH	Sonoscape Medical Corp-A	21,825	61.3	46.5	11.8	9.4
688677 CH	Qingdao Novelbeam Technolo-A	9,320	51.8	38.2	19.5	14.2
688366 CH	Shanghai Haohai Biological-A	16,552	60.4	41.6	7.7	6.5
300595 CH	Ovctek China Inc-A	31,820	45.9	35.2	19.1	14.5
688212 CH	Shanghai Aohua Photoelectr-A	9,607	200.7	105.6	21.3	14.1
688050 CH	Eyebright Medical Technolo-A	24,132	99.6	69.7	38.5	26.7
688271 CH	Shanghai United Imaging He-A	151,315	86.2	64.9	16.4	12.8
1789 HK	AK Medical	10,047	56.1	39.8	10.2	7.5
	Average		65.6	45.5	16.0	11.6

Source: Bloomberg, CMBIGM estimates

Figure 2: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,065	1,444	1,900	1,150	1,532	1,990	-7.4%	-5.8%	-4.5%
Gross profit	660	881	1,150	713	935	1,224	-7.4%	-5.8%	-6.1%
Operating profit	207	301	423	223	319	473	-7.0%	-5.7%	-10.6%
Net profit	193	273	377	207	288	419	-6.6%	-5.3%	-10.1%
EPS (RMB)	0.17	0.24	0.34	0.19	0.26	0.38	-8.8%	-6.0%	-11.2%
Gross margin	62.00%	61.00%	60.50%	62.00%	61.00%	61.50%	0.00 ppt	0.00 ppt	-1.00 ppt
Operating margin	19.47%	20.85%	22.26%	19.43%	20.83%	23.75%	+0.04 ppt	+0.02 ppt	-1.49 ppt
Net Margin	18.14%	18.90%	19.82%	18.00%	18.81%	21.04%	+0.14 ppt	+0.09 ppt	-1.22 ppt

Source: Company data, CMBIGM estimates

Figure 3: Risk-adjusted DCF valuation

DCF Valuation (in Rmb mn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	207	301	423	575	690	821	968	1,133	1,314
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	176	256	360	488	586	697	823	963	1,117
+ D&A	74	74	74	74	89	106	125	146	170
- Change in working capital	103	-163	-208	-222	-266	-317	-374	-438	-508
- Capex	-80	-80	-80	-80	-96	-114	-135	-158	-183
FCFF	274	87	146	261	313	372	439	514	596
Terminal value									9,394
FCF + Terminal value	274	87	146	261	313	372	439	514	9,989

Terminal growth rate	3.0%
WACC	9.54%
Cost of Equity	11.8%
Cost of Debt	5.0%
Equity Beta	0.9
Risk Free Rate	2.80%
Market Risk Premium	10.0%
Target Debt to Asset ratio	30.0%
Effective Corporate Tax Rate	15.0%

PV of enterprise value (RMB mn)	10,047
Net debt (RMB mn)	(797)
Minority interests (RMB mn)	0
Equity value (RMB mn)	10,845
Equity value (HK\$ mn)	12,759
# of shares outstanding (mn)	1,116
Price per share (HK\$)	11.44

Source: CMBIGM estimates

Figure 4: Sensitivity analysis

		WACC				
		8.54%	9.04%	9.54%	10.04%	10.54%
Terminal growth rate	4.0%	16.60	14.67	13.11	11.82	10.74
	3.5%	15.17	13.54	12.20	11.08	10.12
	3.0%	14.00	12.60	11.44	10.44	9.59
	2.5%	13.02	11.81	10.78	9.89	9.13
	2.0%	12.19	11.12	10.20	9.41	8.72

Figure 5: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,065	1,444	1,900	1,077	1,444	1,855	-1.1%	0.0%	2.4%
Gross Profit	660	881	1,150	657	857	1,108	0.5%	2.8%	3.8%
Operating Profit	207	301	423	210	301	428	-1.0%	0.1%	-1.0%
Net profit	193	273	377	196	272	376	-1.5%	0.2%	0.1%
EPS (RMB)	0.17	0.24	0.34	0.18	0.25	0.34	-2.68%	-0.61%	0.46%
Gross Margin	62.00%	61.00%	60.50%	61.02%	59.32%	59.71%	+0.99 ppt	+1.68 ppt	+0.79 ppt
Operating Margin	19.47%	20.85%	22.26%	19.45%	20.83%	23.05%	+0.02 ppt	+0.02 ppt	-0.78 ppt
Net Margin	18.14%	18.90%	19.82%	18.22%	18.85%	20.29%	-0.07 ppt	+0.05 ppt	-0.47 ppt

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	927	1,035	761	1,065	1,444	1,900
Cost of goods sold	(283)	(321)	(262)	(405)	(563)	(751)
Gross profit	643	715	499	660	881	1,150
Operating expenses	(328)	(346)	(400)	(453)	(580)	(727)
Selling expense	(175)	(154)	(187)	(213)	(274)	(352)
Admin expense	(92)	(83)	(105)	(117)	(152)	(190)
R&D expense	(81)	(105)	(113)	(128)	(159)	(190)
Others	20	(4)	6	5	5	5
Operating profit	316	369	99	207	301	423
EBITDA	na	na	na	na	na	497
EBIT	na	na	na	na	na	423
Net Interest income/(expense)	6	8	9	20	20	20
Pre-tax profit	321	377	109	227	321	443
Income tax	(54)	(63)	(16)	(34)	(48)	(66)
Net profit	267	314	93	193	273	377
Minority interest	0	0	0	0	0	0
Net profit attributable to shareholders	267	314	93	193	273	377

BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	1,118	1,903	1,934	2,212	2,511	2,910
Cash & equivalents	277	713	476	727	777	864
Account receivables	272	451	388	438	593	781
Inventories	229	361	423	399	494	617
Other current assets	340	378	648	648	648	648
Non-current assets	364	624	671	677	683	688
PP&E	284	364	382	401	419	437
Deferred income tax	15	51	76	76	76	76
Intangibles	36	76	80	67	55	42
Goodwill	29	133	132	132	132	132
Other non-current assets	0	0	0	0	0	0
Total assets	1,482	2,527	2,605	2,889	3,194	3,598
Current liabilities	328	418	489	618	705	808
Short-term borrowings	0	0	0	0	0	0
Account payables	79	146	93	222	308	411
Tax payable	32	42	52	52	52	52
Other current liabilities	217	230	345	345	345	345
Non-current liabilities	38	66	84	84	84	84
Deferred income	13	12	12	12	12	12
Other non-current liabilities	25	54	72	72	72	72
Total liabilities	366	484	574	703	789	892
Share capital	9	9	9	9	9	9
Other reserves	1,107	2,033	2,022	2,177	2,395	2,696
Total shareholders equity	1,116	2,043	2,032	2,186	2,404	2,706
Minority interest	0	0	0	0	0	0
Total equity and liabilities	1,482	2,527	2,605	2,889	3,194	3,598

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	321	377	109	227	321	443
Depreciation & amortization	28	58	73	74	74	74
Tax paid	(33)	(45)	(29)	(34)	(48)	(66)
Change in working capital	(178)	(186)	31	103	(163)	(208)
Others	6	1	(7)	(20)	(20)	(20)
Net cash from operations	145	205	177	351	164	223
Investing						
Capital expenditure	(107)	(351)	(76)	(80)	(80)	(80)
Net proceeds from disposal of short-term investments	(180)	(548)	(1,039)	0	0	0
Others	15	542	818	20	20	20
Net cash from investing	(272)	(356)	(297)	(60)	(60)	(60)
Financing						
Dividend paid	(32)	(75)	(37)	(39)	(55)	(75)
Net borrowings	2	(2)	0	0	0	0
Proceeds from share issues	0	701	0	0	0	0
Others	9	(13)	(64)	0	0	0
Net cash from financing	(22)	612	(101)	(39)	(55)	(75)
Net change in cash						
Cash at the beginning of the year	421	277	713	476	727	777
Exchange difference	4	(24)	(16)	0	0	0
Cash at the end of the year	277	713	476	727	777	864
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Revenue	54.3%	11.7%	(26.5%)	39.9%	35.5%	31.6%
Gross profit	57.3%	11.1%	(30.1%)	32.3%	33.3%	30.6%
Operating profit	84.3%	16.9%	(73.0%)	108.6%	45.1%	40.6%
Net profit	84.2%	17.6%	(70.5%)	108.7%	41.1%	38.1%
PROFITABILITY	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Gross profit margin	69.4%	69.0%	65.6%	62.0%	61.0%	60.5%
Operating margin	34.0%	35.6%	13.1%	19.5%	20.8%	22.3%
EBITDA margin	na	na	na	na	na	26.2%
Return on equity (ROE)	27.3%	19.9%	4.5%	9.2%	11.9%	14.7%
GEARING/LIQUIDITY/ACTIVITIES	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Net debt to equity (x)	(0.2)	(0.4)	(0.3)	(0.4)	(0.4)	(0.3)
Current ratio (x)	3.4	4.6	4.0	3.6	3.6	3.6
Receivable turnover days	81.1	127.3	201.0	150.0	150.0	150.0
Inventory turnover days	254.8	335.6	545.4	360.0	320.0	300.0
Payable turnover days	86.8	127.8	166.0	200.0	200.0	200.0
VALUATION	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
P/E	19.7	58.0	106.3	43.5	30.8	22.3
P/E (diluted)	20.0	58.3	107.1	43.5	30.8	22.3
Div yield (%)	1.4	0.2	0.2	0.5	0.6	0.9
EV	na	na	na	na	na	8,644.9
EV/Sales	na	na	na	na	na	4.5
EV/EBIT	na	na	na	na	na	20.4
EV/EBITDA	na	na	na	na	na	17.4

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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