

21 Jul, 2023

Clarity Medical | 01406.HK

Time to bottom-out

STOCK RATING

NR

TARGET PRICE

HK\$ -

We participated in the recent site visit of Clarity Medical (01406.HK) held last week and we visited i) the newly opened EVO ICL Premium Center on the 7/F of Wai Fung Plaza, ii) the newly renovated Vision Correction Center on the 10/F of Wai Fung Plaza, and iii) the newly opened Children Myopia Prevention and Control Center in The One. During the site visit, Clarity Medical (01406.HK) presented new business directions which may bring the Group a fundamental change, and the services provided by the Group will become more comprehensive to cover the whole life-cycle of people.

Assessment, Prevention and Control Services for Children: Clarity Medical (01406.HK) commences to provide children prevention and control services in mid-2023 in the Children Myopia Prevention and Control Center. The Group primarily provides assessment services and products for children to prevent and control myopia before too late. It is important to notice that, unlike surgeries, assessment, prevention and control services have to be taken regularly, providing the Group with a more stable revenue source.

ICL Implantation Surgery: The medical center on the 7/F of Wai Fung Plaza was renovated to be the first and the only ICL training center in Hong Kong, and it is jointly established by Clarity Medical (01406.HK) and STAAR Surgical, a major supplier of ICL materials. Being the coming core business of Clarity Medical (01406.HK), we believe that the ICL Implantation Surgery will account for about 20% - 30% of revenue generated from the refractive treatments, and the number of ICL Implantation Surgeries completed will grow to over 1,000 cases per year. However, ICL Implantation Surgery remains too expensive to be popular and the price may decrease when peers get into the market.

Time to bottom-out: It was a difficult time for Clarity Medical (01406.HK) in the 2H of the fiscal year 2022/23, a price competition on SMILE Surgery and a decrease in the number of other surgeries performed drove down the top-line and heavily squeezed the profit margin. However, thanks to the opening of the EVO ICL Premium Center and the Children Myopia Prevention and Control Center, we are positive about the improvement of income sources and we believe that the profit margin will gradually be improved due to the increasing contribution from ICL Implantation Surgeries and SMILE® pro Surgeries. Therefore, we expect that the Group will bottom-out and enjoy a recovery after hitting the bottom.

COMPANY NOTE

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Clarity Medical (01406.HK)

Stock Rating **NR**
Target Price **HK\$ -**

 Current Price **HK\$ 0.90**

 52-Week Range **HK\$ 0.80 – 1.61**

 Market cap. (HKD, bn) **HK\$ 0.5**

RMB, mn	2019/	2020/	2021/	2022/
	20 (A)	21 (A)	22 (A)	23 (A)
Revenue	218.4	222.4	225.2	213.8
Operating Profit	34.3	44.7	19.8	(1.4)
Operating Margin	15.7%	20.1%	8.8%	-0.7%
Net Profit	26.4	35.8	13.5	(3.2)
ROE	32.7%	35.2%	8.0%	-1.2%

Performance	1 mth	3 mth	6 mth	1 year
Absolute	5.9%	-12.6%	-21.1%	-12.6%
Relative to HSI	9.3%	-5.4%	-6.9%	-3.2%



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Exhibit: GFA of the medical centers of Clarity Medical (01406.HK)

	Central	Mong Kok	Tsim Sha Tsui	Total
IPO	7,077	9,859	-	16,936
31 Mar 2023	7,077	15,825	13,674	36,576

Source: Company data, West Bull Securities

During the site visit, Clarity Medical (01406.HK) presented new business directions which may bring the Group a fundamental change, and the services provided by the Group will become more comprehensive to cover the whole life-cycle of people.

Exhibit: Product portfolio of Clarity Medical (01406.HK)



Source: Company data

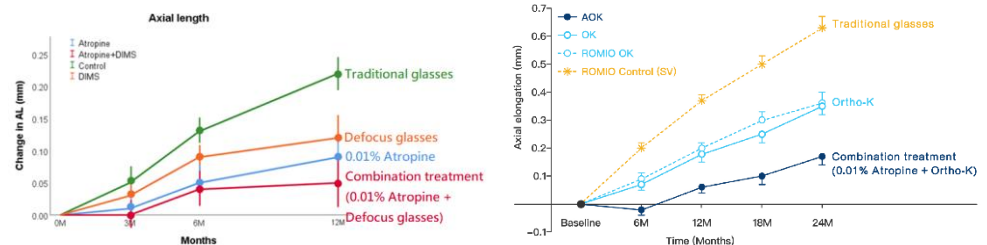
Assessment, Prevention and Control Services for Children

Clarity Medical (01406.HK) commences to provide children prevention and control services in mid-2023 in the Children Myopia Prevention and Control Center, and the service center locates in a popular shopping mall, The One, in Tsim Sha Tsui, a CBD area in Hong Kong.

The Group primarily provides assessment services (incl. visual acuity, refraction, colour vision, stereopsis, binocular vision, intraocular pressure, fundus imaging, axial length, ocular health etc.) and products (incl. Atropine, Ortho-K lenses and defocused glasses) for children to prevent and control myopia before too late. About HKD 2,400 (before the discount) and HKD 6,000 (before the discount) will be charged for the assessment services and products for myopia prevention and control respectively, and it will be a new income stream for Clarity Medical (01406.HK).

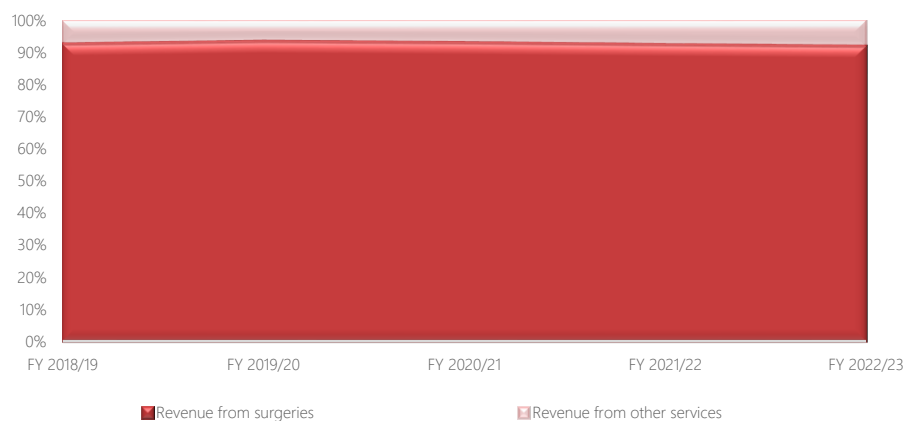
It is important to notice that, unlike surgeries, assessment, prevention and control services have to be taken regularly, providing the Group with a more stable revenue source. We believe that the myopia prevention and control services will account for approximately 10% of total revenue in 2 – 3 years.

Exhibit: Effectiveness for combined therapy



Source: Company data

Exhibit: Revenue breakdown by service types



Source: Company data, West Bull Securities

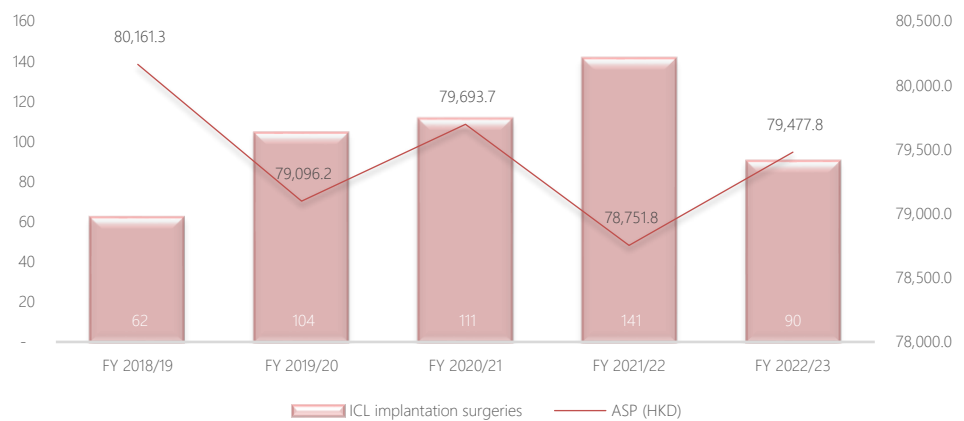
ICL Implantation Surgery

The medical center on the 7/F of Wai Fung Plaza was renovated to be the first and the only ICL training center in Hong Kong, and it is jointly established by Clarity Medical (01406.HK) and STAAR Surgical, a major supplier of ICL materials.

ICL, Implantable Contact Lens, is a customized soft lens that effectively corrects myopia, hyperopia, and astigmatism, restoring 90% of vision within 24 hours. ICL Implantation Surgery implants the ICL between the iris and the natural lens, it is suitable for clients who i) suffer from -18.0 diopters myopia or 10.0 diopters hyperopia or 6.0 diopters astigmatism, ii) are unable to qualify for laser refractive surgery, iii) suffer from dry eyes, iv) have thin corneas. More importantly, the surgery is reversible and it just takes 10 – 15 minutes.

Being the coming core business of Clarity Medical (01406.HK), we believe that the ICL Implantation Surgery will account for about 20% - 30% of revenue generated from the refractive treatments, and the number of ICL Implantation Surgeries completed will grow to over 1,000 cases per year. However, ICL Implantation Surgery remains too expensive (about 2x of SMILE® Pro and 3x of SMILE 1.0) to be popular and the price may decrease when peers get into the market.

Exhibit: ASP and number of ICL Implantation Surgery completed



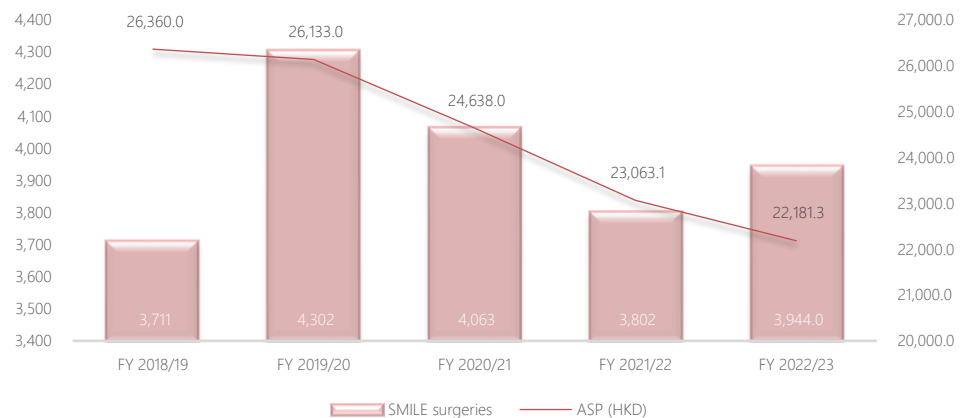
Source: Company data, West Bull Securities

From SMILE 1.0 to SMILE®pro

Clarity Medical (01406.HK) introduced the second generation of SMILE Surgery and called it SMILE®pro, and the Group is one of the three pioneers in Hong Kong introducing the latest technology of SMILE Surgery. When compared to the current generation of technology, the SMILE®pro i) adopts the Centralign® system and OcuLign® system to improve efficiency and safety, ii) shortens the surgery time from 25s to 10s, and iii) shortens the recovery time. Given similar consumables and profit-sharing mechanisms, the higher pricing (SMILE®pro: ~HKD 30,000 vs SMILE 1.0: ~HKD 20,000) will bring the Group a better profit margin.

However, given an approximately 50% premium on SMILE®pro, we believe that the penetration rate will be more significant in the longer term. Besides, given a thin profit margin for SMILE 1.0, we do have concerns about the profitability of the Group in the short term because SMILE Surgery is one of the primary income sources of the Group.

Exhibit: ASP and number of SMILE Surgery completed



Source: Company data, West Bull Securities

Time to bottom-out

It was a difficult time for Clarity Medical (01406.HK) in the 2H of the fiscal year 2022/23, a price competition on SMILE Surgery and a decrease in the number of other surgeries performed drove down the top-line and heavily squeezed the profit margin. However, thanks to the opening of the EVO ICL Premium Center and the Children Myopia Prevention and Control Center, we are positive about the improvement of income sources and we believe that the profit margin will gradually be improved due to the increasing contribution from ICL Implantation Surgeries and SMILE®pro Surgeries. Therefore, we expect that the Group will bottom-out and enjoy a recovery after hitting the bottom in the past fiscal year.

Peers comparison

		Mkt. Cap.	P/E	Fw. P/E	P/B	P/S	Revenue	GM	ROE
		(HKD, mn)	(x)	(x)	(x)	(x)	(HKD, mn)	(%)	(%)
01846.HK	Euroeyes	1,489.6	15.7	9.5	1.4	2.3	610.3	44.4	8.9
02219.HK	Chaoju Eye Care	3,276.3	15.8	13.1	1.3	3.0	1,152.8	43.9	8.6
03309.HK	C-MER Eye	4,850.9	-	54.7	2.6	2.7	1,731.9	25.9	(1.4)
300015.CH	Aier Eye	203,128.7	52.1	46.9	8.2	8.3	18,759.0	50.5	18.4
	<i>Average</i>	<i>53,186.4</i>	<i>7.8</i>	<i>31.1</i>	<i>3.4</i>	<i>4.1</i>	<i>5,563.5</i>	<i>41.1</i>	<i>8.6</i>
01406.HK	Clarity Medical	475.3	-	-	1.8	2.2	213.8	-	(1.2)

Source: Bloomberg, West Bull Securities

Risk factors

- Limited market education leads to a low penetration rate for the children prevention and control services in Hong Kong
- The price premium and insignificant difference between SMILE®pro and SMILE 1.0 results in a low penetration rate for the SMILE®pro
- Price competition further squeezes the profit margin of SMILE 1.0 and other traditional surgeries
- Increasing competition results in a decrease in the ASP of SMILE®pro and ICL Implantation Surgery

Financial Statement

PnL					Balance Sheet				
(HKD, mn)	2019/20 (A)	2020/21 (A)	2021/22 (A)	2022/23 (A)	(HKD, mn)	2019/20 (A)	2020/21 (A)	2021/22 (A)	2022/23 (A)
Revenue	218.4	222.4	225.2	213.8	PPE	24.5	25.2	17.7	33.8
YoY growth	5.7%	1.8%	1.3%	-5.1%	Others	31.3	12.6	22.9	59.8
COGS	-	-	-	-	Non-current assets	55.7	37.8	40.6	93.6
Gross profit	218.4	222.4	225.2	213.8	Inventories	5.7	4.2	3.7	3.7
Other income	(0.0)	7.0	1.7	6.3	Trade receivables	0.8	1.9	1.1	2.0
Operating expenses	(184.1)	(184.6)	(207.1)	(221.6)	Cash & cash equivalents	65.6	64.9	241.3	207.5
Operating profit	34.3	44.7	19.8	(1.4)	Others	41.4	8.4	3.5	20.5
Finance expenses	(1.1)	(0.9)	(0.8)	(1.5)	Current assets	113.6	79.4	249.6	233.7
JV & Ass.	-	-	-	-	Total assets	169.3	117.2	290.1	327.3
Profit before tax	33.2	43.8	19.0	(2.9)	LT borrowings	-	-	-	-
Tax	(6.8)	(8.0)	(5.6)	(0.3)	Others	11.2	5.1	10.5	27.8
Net profit	26.4	35.8	13.5	(3.2)	Non-current liabilities	11.2	5.1	10.5	27.8
YoY growth	-12.2%	35.6%	-62.3%	-123.7%	Trade payables	7.9	8.4	5.9	7.2
					ST borrowings	3.8	-	-	-
					Others	23.6	23.1	18.3	33.0
					Current liabilities	35.4	31.5	24.2	40.2
					Total liabilities	46.6	36.7	34.7	68.0
					Non-controlling interests	-	-	-	-
					Controlling interests	122.7	80.5	255.4	259.3
					Total equities	122.7	80.5	255.4	259.3

Cash Flow

(HKD, mn)	2019/20 (A)	2020/21 (A)	2021/22 (A)	2022/23 (A)	Financial Ratio	2019/20 (A)	2020/21 (A)	2021/22 (A)	2022/23 (A)
Profit before tax	33.2	43.8	19.0		Operating margin	15.7%	20.1%	8.8%	-0.7%
Finance expenses	1.1	0.9	0.8		Net profit margin	12.1%	16.1%	6.0%	-1.5%
Finance income	-	-	(0.0)		Adj. EBITDA profit margin	20.6%	27.4%	19.6%	-0.2%
D&A	6.8	8.4	7.7		Return on Equity	32.7%	35.2%	8.0%	-1.2%
Others	5.9	14.4	2.8		Return on Asset	21.1%	25.0%	6.6%	-1.0%
Change in working capital	(5.9)	3.8	(2.7)		Current ratio	320.9%	251.6%	1031.5%	581.3%
CFO	41.1	71.4	27.6		Quick ratio	304.7%	238.3%	1016.1%	572.1%
					Cash ratio	185.5%	205.6%	997.1%	516.2%
CAPEX	(5.6)	(9.2)	(0.2)		Debt-to-Equity ratio	3.1%	0.0%	0.0%	0.0%
Others	(39.0)	(34.4)	0.0	Not released	Net Debt-to-Equity ratio	-50.4%	-80.6%	-94.5%	-80.0%
CFI	(44.7)	(43.5)	(0.2)	yet					
Shares issuance	55.0	-	205.5						
Net borrowings	(3.7)	(3.8)	-						
Dividend paid	-	-	-						
Others	-	(5.3)	(26.0)						
CFF	(16.7)	(19.5)	(30.5)						
	34.6	(28.6)	149.0						
FCFE									
FCFF	31.8	58.3	27.3						

Source: Company data, West Bull Securities

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