

AK Medical (1789 HK)

Resilient performance in 1H24, expecting recovery in 2H24

AK Medical reported 1H24 revenue of RMB657mn, up 1.3% YoY and largely in line with our forecast, accounting for 46% of our previous full-year estimate. Attributable net profit increased by 5.0% YoY to RMB139mn, reaching 52% of our previous full-year estimate. Attributable net profit margin expanded 0.8ppt YoY to 21.2% thanks to effective cost management, partially offset by a decline in gross margin. AK Medical's gross profit margin declined by 1.3ppts YoY to 60.6% in 1H24 due to a higher proportion of revenue from VBP products. The ongoing anti-corruption campaign continued to negatively affect domestic sales of non-VBP products in 1H24. We estimate that AK's domestic sales of non-VBP products decreased by approximately 12% YoY while sales of VBP products grew around 6% YoY in 1H24.

■ **Joint implant sales demonstrated resilience despite a high base in 1H23.** In 1H24, sales of joint implants grew 0.5% YoY to RMB555mn, following a robust performance in 1H23 fueled by a recovery in orthopedic surgery demand. We estimate that the overall surgery volumes have rebounded from the challenging business environment in 2H23. However, revision products and partial knees were still under pressure due to a high base and the anti-corruption campaign. With the implementation of VBP renewals from 2H24 and the low base effect, we expect AK Medical's hip and knee replacement implants will deliver strong revenue growth of 28% YoY in 2024E. AK Medical's primary knee implants secured a 40% volume increase and over 15% price rise during the VBP renewals. Prices of ceramic-on-ceramics (C-on-C) hip joints and ceramics on polyethylene (C-on-P) hip joint also improved by approximately 15% and 12%, respectively. AK Medical's prices of primary hip implants are now on par with other manufacturers, enabling the Company to incentivize distributors to promote AK's products with competitive margins.

■ **3D printed spine products drove robust revenue growth of spinal and trauma implants.** Revenue of spinal and trauma implants reached RMB69mn in 1H24 (+37.6% YoY), primarily driven by 3D-printed vertebral bodies which are not covered by the national VBP of spinal implants. AK Medical rapidly expanded its hospital coverage by entering 56 new hospitals, including 30 provincial hospitals, in 1H24. We expect continued robust growth for spinal and trauma implants.

■ **Maintain BUY.** We expect AK Medical's revenue and attributable net profit to increase by 25.0% /44.8 % YoY in 2024E. We revise our TP to HK\$5.27 based on a 9-year DCF model (WACC: 10.11%, terminal growth rate: 2.0%).

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	1,052	1,094	1,367	1,665	2,000
YoY growth (%)	38.2	4.0	25.0	21.8	20.2
Net profit (RMB mn)	204.8	182.1	263.8	338.3	407.4
YoY growth (%)	121.1	(11.1)	44.8	28.3	20.4
EPS (Reported) (RMB)	0.18	0.16	0.24	0.30	0.36
YoY growth (%)	121.8	(11.4)	43.7	28.3	20.4
P/E (x)	19.5	22.0	15.3	11.9	9.9
Yield (%)	1.5	1.1	1.6	2.1	2.5
ROE (%)	9.6	7.9	10.6	12.5	13.6
Net gearing (%)	(28.0)	(11.8)	(13.3)	(15.7)	(19.1)

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$5.27**

(Previous TP) **HK\$7.20**

Up/Downside **33.5%**

Current Price **HK\$3.95**

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Stock Data

Mkt Cap (HK\$ mn)	4,431.8
Avg 3 mths t/o (HK\$ mn)	9.4
52w High/Low (HK\$)	7.92/3.58
Total Issued Shares (mn)	1122.0

Source: FactSet

Shareholding Structure

Ximalaya Limited	45.0%
Goldman Sachs International	9.3%

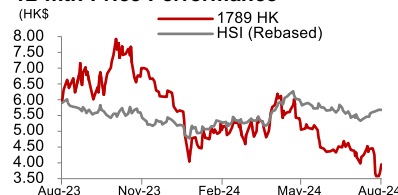
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-9.8%	-12.6%
3-mth	-21.8%	-18.7%
6-mth	-22.2%	-27.8%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY25E
Revenue	1,367	1,665	2,000	1,429	1,810	2,231	-4.3%	-8.0%	-10.3%
Gross profit	834	1,041	1,250	882	1,117	1,376	-5.4%	-6.8%	-9.2%
Operating profit	289	373	448	309	395	493	-6.3%	-5.5%	-9.1%
Net profit	264	338	407	270	344	430	-2.2%	-1.6%	-5.2%
EPS (RMB)	0.24	0.30	0.36	0.24	0.31	0.38	-2.2%	-1.6%	-5.2%
Gross margin	61.00%	62.50%	62.50%	61.70%	61.70%	61.70%	-0.70 ppt	+0.80 ppt	+0.80 ppt
Operating margin	21.16%	22.40%	22.40%	21.60%	21.81%	22.10%	-0.44 ppt	+0.60 ppt	+0.30 ppt
Net Margin	19.29%	20.32%	20.37%	18.88%	18.99%	19.26%	+0.42 ppt	+1.33 ppt	+1.10 ppt

Source: Company data, CMBIGM estimates

Figure 2: Risk-adjusted DCF valuation

DCF Valuation (in RMB mn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
EBIT	289	373	448	531	611	696	786	881	978
Tax rate	15%	15%	15%	15%	15%	15%	15%	15%	15%
EBIT*(1-tax rate)	246	317	381	451	519	592	668	749	831
+ D&A	91	91	91	91	105	119	135	151	167
- Change in working capital	-76	-92	-93	-69	-79	-90	-102	-114	-127
- Capex	-150	-150	-150	-150	-173	-197	-222	-249	-276
FCFF	110	166	229	323	372	424	479	536	595
Terminal value									7,483

Terminal growth rate	2.0%
WACC	10.11%
Cost of equity	13.5%
Cost of debt	4.5%
Equity beta	1.00
Risk-free rate	3.00%
Market risk premium	10.5%
Target debt to asset ratio	35.0%
Effective corporate tax rate	15.0%

PV of enterprise value (RMB mn)	4,982
Net debt (RMB mn)	(345)
Minority interests (RMB mn)	0
Equity value (RMB mn)	5,326
Equity value (HK\$ mn)	5,918
# of shares outstanding (mn)	1,122
Price per share (HK\$)	5.27

Source: CMBIGM estimates

Figure 3: Sensitivity analysis

		WACC				
		9.11%	9.61%	10.11%	10.61%	11.11%
Terminal growth rate	3.0%	6.79	6.23	5.75	5.33	4.97
	2.5%	6.42	5.93	5.50	5.12	4.79
	2.0%	6.11	5.66	5.27	4.93	4.63
	1.5%	5.84	5.44	5.08	4.76	4.48
	1.0%	5.60	5.23	4.91	4.61	4.35

Source: CMBIGM estimates

Figure 4: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY25E
Revenue	1,367	1,665	2,000	1,410	1,795	2,206	-3.0%	-7.3%	-9.3%
Gross profit	834	1,041	1,250	872	1,117	1,379	-4.4%	-6.8%	-9.3%
Operating profit	289	373	448	297	389	491	-2.5%	-4.1%	-8.7%
Net profit	264	338	407	271	344	389	-2.5%	-1.5%	4.7%
EPS (RMB)	0.24	0.30	0.36	0.25	0.32	0.38	-4.0%	-5.8%	-4.4%
Gross margin	61.00%	62.50%	62.50%	61.87%	62.22%	62.50%	-0.87 ppt	+0.28 ppt	0.00 ppt
Operating margin	21.16%	22.40%	22.40%	21.05%	21.67%	22.26%	+0.11 ppt	+0.73 ppt	+0.14 ppt
Net margin	19.29%	20.32%	20.37%	19.18%	19.14%	17.63%	+0.11 ppt	+1.19 ppt	+2.73 ppt

Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	761	1,052	1,094	1,367	1,665	2,000
Cost of goods sold	(262)	(416)	(419)	(533)	(624)	(750)
Gross profit	499	636	674	834	1,041	1,250
Operating expenses	(400)	(416)	(463)	(545)	(668)	(802)
Selling expense	(187)	(180)	(219)	(271)	(333)	(400)
Admin expense	(105)	(118)	(133)	(157)	(188)	(222)
R&D expense	(113)	(111)	(137)	(137)	(166)	(200)
Others	6	(7)	26	20	20	20
Operating profit	99	220	211	289	373	448
Net Interest income/(expense)	9	20	20	21	25	31
Pre-tax profit	109	240	231	310	398	479
Income tax	(16)	(36)	(49)	(47)	(60)	(72)
After tax profit	93	205	182	264	338	407
Minority interest	0	0	0	0	0	0
Net profit	93	205	182	264	338	407

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	1,934	2,065	1,975	2,148	2,379	2,675
Cash & equivalents	476	626	331	394	496	649
Account receivables	388	467	451	574	653	730
Inventories	423	402	596	584	633	699
Other current assets	648	570	597	597	597	597
Non-current assets	671	709	1,028	1,087	1,146	1,205
PP&E	382	436	575	648	722	795
Deferred income tax	76	75	67	67	67	67
Intangibles	80	85	88	74	59	45
Goodwill	132	113	113	113	113	113
Other non-current assets	0	0	185	185	185	185
Current liabilities	489	436	498	533	569	618
Short-term borrowings	0	0	21	21	21	21
Account payables	93	155	175	210	246	295
Tax payable	52	23	18	18	18	18
Other current liabilities	345	258	284	284	284	284
Non-current liabilities	84	94	113	113	113	113
Deferred income	12	13	10	10	10	10
Other non-current liabilities	72	81	103	103	103	103
Total liabilities	574	531	611	646	682	731
Share capital	9	9	10	10	10	10
Other reserves	2,022	2,234	2,382	2,580	2,834	3,140
Total equity	2,032	2,244	2,392	2,590	2,843	3,149
Minority interest	0	0	0	0	0	0
Total equity and liabilities	2,605	2,774	3,003	3,236	3,525	3,880

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	109	240	231	310	398	479
Depreciation & amortization	73	79	87	91	91	91
Tax paid	(29)	(57)	(46)	(47)	(60)	(72)
Change in working capital	31	(40)	(236)	(76)	(92)	(93)
Others	(7)	22	(3)	(21)	(25)	(31)
Net cash from operations	177	243	34	257	312	374
Investing						
Capital expenditure	(76)	(122)	(196)	(150)	(150)	(150)
Net proceeds from disposal of short-term investments	(1,039)	(1,921)	(1,762)	0	0	0
Others	818	1,960	1,640	21	25	31
Net cash from investing	(297)	(82)	(318)	(129)	(125)	(119)
Financing						
Dividend paid	(37)	(24)	(62)	(66)	(85)	(102)
Net borrowings	0	0	0	0	0	0
Proceeds from share issues	0	0	0	0	0	0
Others	(64)	(13)	47	0	0	0
Net cash from financing	(101)	(37)	(14)	(66)	(85)	(102)
Net change in cash						
Cash at the beginning of the year	713	476	626	331	394	496
Exchange difference	(16)	26	4	0	0	0
Cash at the end of the year	476	626	331	394	496	649
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	(26.5%)	38.2%	4.0%	25.0%	21.8%	20.2%
Gross profit	(30.1%)	27.5%	6.0%	23.6%	24.8%	20.2%
Operating profit	(73.0%)	121.2%	(3.9%)	36.8%	28.9%	20.2%
Net profit	(70.5%)	121.1%	(11.1%)	44.8%	28.3%	20.4%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	65.6%	60.5%	61.7%	61.0%	62.5%	62.5%
Operating margin	13.1%	20.9%	19.3%	21.2%	22.4%	22.4%
Return on equity (ROE)	4.5%	9.6%	7.9%	10.6%	12.5%	13.6%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.3)	(0.3)	(0.1)	(0.1)	(0.2)	(0.2)
Current ratio (x)	4.0	4.7	4.0	4.0	4.2	4.3
Receivable turnover days	201.0	148.3	153.2	153.2	143.2	133.2
Inventory turnover days	545.4	362.4	434.2	400.0	370.0	340.0
Payable turnover days	166.0	108.9	143.6	143.6	143.6	143.6
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	43.3	19.5	22.0	15.3	11.9	9.9
P/E (diluted)	43.6	19.7	22.1	15.3	11.9	9.9
Div yield (%)	0.6	1.5	1.1	1.6	2.1	2.5
EV/Sales	4.5	3.2	3.3	2.6	2.1	1.7

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

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