

Analyst: Kelvin Li

**Main Board Listing – Research**
AK Medical Holdings Limited (01789)
**Sole Sponsor**

Goldman Sachs

**Sector** : Health Care Equipment & Services

**Business** : Development and sales of orthopaedic implants

|  |   |
|--|---|
| <p><b>Total share offer:</b> <u>250,000,000</u> shares<br/>(25% of the enlarged share capital)</p> <p><b>Public Offer:</b> 25,000,000 shares (10%)</p> <p><b>Placing:</b> 225,000,000 shares (90%)</p> <p><b>Greenshoe:</b> 37,500,000 shares</p> <hr/> <p><b>Price:</b> HK\$1.66 – HK\$2.00 per share</p> <p><b>Total Market Capitalisation:</b><br/>HK\$1,660 million - HK\$2,000 million</p> <p><b>Pro-forma fully diluted FY2016 P/E:</b> 17.3x-20.8x</p> <p><b>Adjusted NTA per share:</b> HK\$0.72-HK\$0.80</p> <p><b>Staffing:</b> 345 (as of 27<sup>th</sup> November 2017)</p> <hr/> <p><b>HK Public Offer period:</b><br/>7<sup>th</sup> December 2017 – 12<sup>th</sup> December 2017</p> <p><b>Receiving bank:</b><br/>Standard Chartered Bank (Hong Kong)</p> <p><b>Share registrar:</b><br/>Tricor Investor Services Limited</p> <p><b>Listing date:</b> 20<sup>th</sup> December 2017</p> | <p><b><u>Business of AK Medical (“The Group”)</u></b></p> <p>The Group is mainly engaged in the design, development, production and marketing of orthopedic implants, with a focus on hip and knee replacement implants. The Group rolled out its 3D-printed spinal interbody cages and artificial vertebral bodies in 2016, and became the first and only medical device company that has commercialized the application of 3D-printing technology in orthopedic joint and spine replacement implants in China.</p> <p>The Group’s products include orthopedic joint implants for primary surgeries as well as those specifically designed for revision surgeries for the replacement, repair or enhancement of an implant or component from a previous procedure. As of June 30, 2017, the Group had 650 distributors, covering all the provinces, municipalities and autonomous regions in China. The Group’s production facilities are in Beijing and the new facility in Changzhou is in the preparatory stage for construction.</p> |
|--|---|

**Shareholding Structure after Listing:**

|  |            |
|--|------------|
| • Ximalaya – 50% owned by Mr. Li Zhijiang (the Group Chairman & CEO) and 50% by Trident Trust (family trust of Chairman Li)  | 58.51575%  |
| • OrbiMed Asia (pre-IPO investor) (an independent third party with focus on healthcare investments)  | 7.50000%   |
| • Zhang Chaoyang (executive Director)  | 6.74325%   |
| • Sanbao – 32.42% owned by Li Huijiang (sister of Chairman Li), 30.22% by Zhao Xiaohong (CFO), 19.23% by Qi Yajun (senior management), 8.24% by Wang Caimei (senior management), 8.24% by Liu Aiguo (senior management) and 1.65% by Zhang Weiping (senior management) | 1.22850%   |
| • Zhang Bin (executive Director and spouse of Chairman Li)   | 1.01250%   |
| • Public shareholders  | 25.00000%  |
|  | 100.00000% |

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## Use of Proceeds

Net proceeds from the offer are estimated to be HK\$386.5 million (based on offer price of HK\$1.83).

|  | HK\$ million |
|--|--------------|
| For expansion of capacity              | 158.5        |
| For product and technology enhancement | 81.2         |
| For research & development             | 58.0         |
| For potential acquisition              | 58.0         |
| For general working capital            | 30.8         |

## Financial Highlights

|  | Year ended 31 <sup>st</sup> December |                   |                   | 6 months ended            |                           |
|--|--------------------------------------|-------------------|-------------------|---------------------------|---------------------------|
|  | 2014                                 | 2015              | 2016              | 30 <sup>th</sup> Jun 2016 | 30 <sup>th</sup> Jun 2017 |
|  | RMB million                          | RMB million       | RMB million       | RMB million               | RMB million               |
| Revenue                                    | 148.3                                | 206.2             | 270.8             | 115.3                     | 162.5                     |
| Gross profit                               | 101.3                                | 142.1             | 187.3             | 79.9                      | 111.7                     |
| Operating profit                           | 57.8                                 | 73.0              | 93.4              | 37.7                      | 57.7                      |
| <b>Profit attributable to shareholders</b> | <b>51.7</b>                          | <b>65.0</b>       | <b>81.5</b>       | <b>34.7</b>               | <b>49.3</b>               |
| Gross profit margin                        | 68.3%                                | 68.9%             | 69.2%             | 69.2%                     | 68.7%                     |
| Operating profit margin                    | 39.0%                                | 35.4%             | 34.5%             | 32.7%                     | 35.5%                     |
| Net profit margin                          | 34.9%                                | 31.5%             | 30.1%             | 30.0%                     | 30.3%                     |
|  | <b>31/12/2014</b>                    | <b>31/12/2015</b> | <b>31/12/2016</b> | <b>30/6/2016</b>          | <b>30/6/2017</b>          |
| Net debt to shareholders' equity           | Net cash                             | Net cash          | Net cash          | N/A                       | Net cash                  |

## Peer valuation comparison

|                       | AK Medical<br>(01789)   |         | Microport<br>(00853) |         | Weigao<br>(01066)           |         |
|-----------------------|-------------------------|---------|----------------------|---------|-----------------------------|---------|
|                       | FY2016                  | FY2017E | FY2016               | FY2017E | FY2016                      | FY2017E |
| Gross profit margin   | 69.2%                   | N/A     | 69.7%                | 73.1%   | 61.5%                       | 61.3%   |
| P/E ratio             | 17.3x-20.8x             | N/A     | 76.6x                | 36.2x   | 18.8x                       | 13.8x   |
| Market capitalisation | HK\$1,660-2,000 million |         | HK\$11,067 million   |         | HK\$9,852 million (H share) |         |

Sources: Reuters

## Strengths/Opportunities

- ✓ The Group is a leading producer of orthopaedic joint implants in China. In terms of sales volume in 2016, the Group had a market share of 14.3%, followed by the second largest player with a 10.9% share. In terms of revenue in 2016, the Group only ranked the sixth in the market, as the product price of domestic producers was substantially lower than imported implants produced by international players.
- ✓ The PRC orthopaedic joint implant market, where the Group operates, grew at a CAGR of 13.9% during 2012-2016 and is expected to maintain steady growth of CAGR of 13.7% in 2016-2021.
- ✓ The annual production capacity of the Group's existing production facilities in Beijing was 102,000 sets of off-the-shelf orthopaedic joint implants in 2016. The designed capacity of the new Changzhou Facilities would reach 150,000 sets of off-the-shelf orthopaedic joint implants by 2021, which will significantly lift the Group's capacity in the next few years.
- ✓ The Group plans to price its IPO at 17x-21x historical P/E, which looked reasonable given the Group's solid growth momentum and stable profit margins.



**Weaknesses/Threats**

- × The industry where the Group operates is highly competitive. The Group needs to cope with rivalry from both domestic and international players.
- × The Group needs to obtain certain permits and product registration certificates for its new Changzhou production facility. If the Group fails to do so in a timely manner, its development plan will be negatively affected.

**Recommendation:      Neutral**



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