

# Shandong Weigao Group Medical Polymer Co Ltd

Bloomberg : 1066 HK Equity | Reuters : 1066.HK | TR PermID : 4295864973

DBS Group Research . Equity

31-Mar-2022 (View Latest Version )

## ANALYST

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**BUY**

Price	Mkt Cap	Target Price	Total Return
HKD 8.8	HKD 39.80 B	HKD 17.7	104.0%

## WHAT'S NEW

2022-03-30 18:33:58

- **FY21 earnings of Rmb2.24bn below consensus by 9% due to one-off litigation claim of Rmb523m.**
- **FY21 revenue of Rmb13bn up 13.2% y-o-y, in-line with consensus.**
- **With net cash of HK\$3bn as of Dec 2021, balance sheet remains healthy**

## INVESTMENT THESIS

### Share price driven by import substitution and strong R&D

- **20% revenue CAGR in 2020-23F to drive share price.** This is mainly thanks to launch of >10 new patented products a year.
- **Proven ability to grow acquired businesses.** Proven record to grow acquired businesses and spin them off for IPO to unlock value.
- **Market share gain from substituting imports.** Its cost advantage will give the company an edge.

## STOCK PRICE



## PE:

Our TP of HK\$17.7 is based on 27x FY21F PE, pegged to 50% discount to industry average. The 50% discount is due to Weigao's heavy exposure (>50% of sales) to low value consumables (e.g. catheters), which faces intense competition.

## Where we differ

Bloomberg consensus estimates the company's revenue growth will decelerate from 21% in 21F to 17% in 23F. We believe the revenue growth can maintain at or above 20% thanks to continuous launch of patented products.

## Key Risks to Our View:

Price cuts imposed by provincial governments for regional volume-based procurement.

## FORECASTS AND VALUATION (CNY, M)

FY Dec	FY2018A	FY2020A	FY2021F	FY2022F
Revenue	8,809	11,345	13,567	16,357
EBITDA	2,451	3,251	3,663	4,332
Pre-tax Profit	1,775	2,496	3,012	3,645
Net Profit	1,473	2,030	2,446	2,960
Net Pft (Pre Ex.)	1,473	2,030	2,446	2,960
Net Pft Gth (Pre-ex) (%)	17.3	9.7	20.5	21.0
EPS (HKD)	0.375	0.539	0.670	0.813
EPS Pre Ex. (HKD)	0.375	0.539	0.670	0.813
EPS Gth Pre Ex (%)	17.3	9.7	20.5	21.0
Diluted EPS (HKD)	0.374	0.537	0.668	0.810
Net DPS (HKD)	0.116	0.074	0.200	0.243
BV Per Share (HKD)	3.69	4.64	5.38	5.96
PE (x)	33.1	24.0	20.0	16.5
PE Pre Ex. (x)	33.1	24.0	20.0	16.5
P/Cash Flow (x)	22.0	18.1	17.5	17.1
EV/EBITDA (x)	20.5	14.3	12.2	10.1
Net Div Yield (%)	0.9	0.6	1.5	1.8
P/Book Value (x)	3.4	2.8	2.5	2.2
Net Debt/Equity (x)	0.1	0	0	0
ROAE (%)	10.6	12.0	13.1	14.3

## WHAT'S NEW

Date	Title
2022-03-30 18:33:58	In-Depth Analysis: Shandong Weigao (1066 HK, BUY): FY21 earnings below consensus by 9%
	<ul style="list-style-type: none"><li>• <b>FY21 earnings of Rmb2.24bn below consensus by 9% due to one-off litigation claim of Rmb523m.</b></li><li>• <b>FY21 revenue of Rmb13bn up 13.2% y-o-y, in-line with consensus.</b></li><li>• <b>With net cash of HK\$3bn as of Dec 2021, balance sheet remains healthy</b></li><li>• <b>After share price correction of 10.5% YTD, the stock is now trading at 11x 22F PE, which is the trough level in last 3 years, downside limited</b></li><li>• <b>Final DPS of RMB0.065 was declared (FY21 interim: RMB0.077), representing a total payout ratio of c.26%. We currently have a BUY rating with TP HK\$17.7.</b></li></ul>

## CRITICAL EQUITY FACTORS (CF)

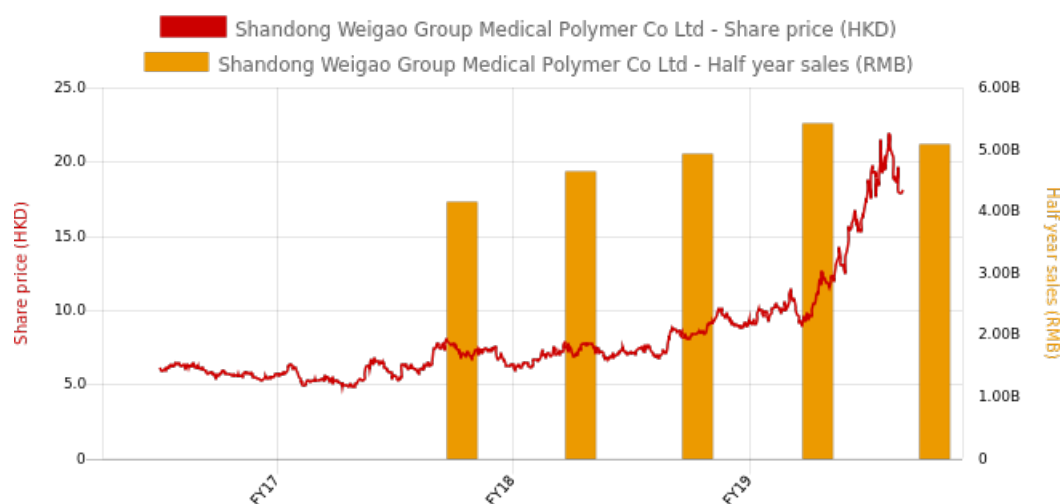
### CF 1: Rapid revenue growth to drive share price

28 Dec 2020

Our chart in “analysis” suggests that revenue growth can drive share price. In terms of y-o-y revenue growth, the company has been decelerating from 19% in 1H19 to 3% in 1H20 because of COVID-19-induced reduction in patient visits to hospitals that dragged down the medical products intake from hospitals. We project revenue growth will rebound to 18% in 2021F and 19% in 2022F driven by:

1. Rapid penetration into new customers via bulk procurement. More than 50% of Weigao sales is from top tier hospitals. Its exposure in lower tier hospitals is relatively small. Weigao can penetrate lower tier hospitals rapidly via regional bulk procurements. Once it won the bids, hospitals at all level in the region will purchase its medical products. In 1H20, Weigao won bids in many provinces. Thus, we believe it can keep on to grow its revenue through winning regional bids.
2. Launch >30 new products a year to fuel growth. Thanks to its strong R&D, Weigao has launched >30 new products annually in the last decade, resulting in gross margin rising from 40% (2004) to 63% (2019). Gross margin is expected to remain high on its new product plans.

### Shandong Weigao Group Medical Polymer Co Ltd - Share price vs. Half year sales



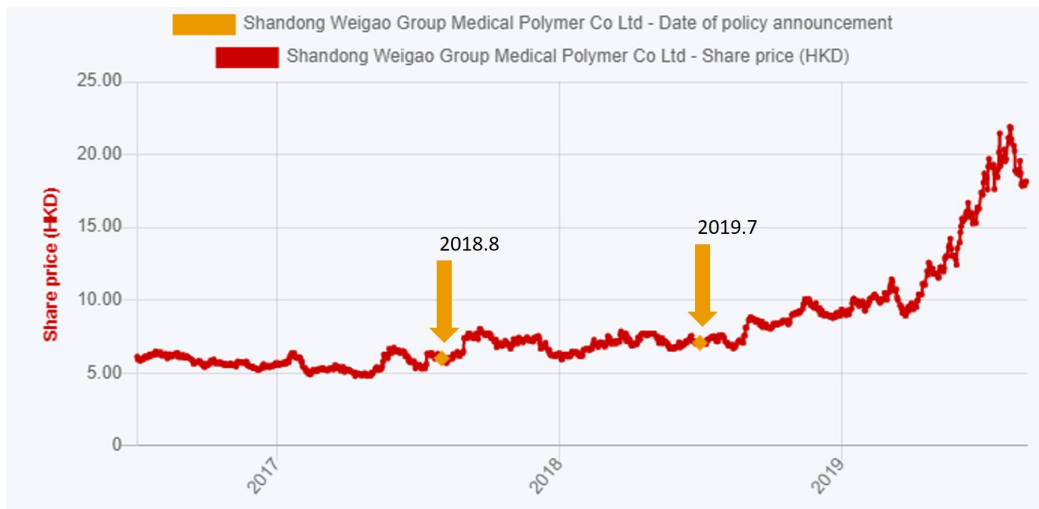
### CF 2: Industry policy encouraging domestic brands to substitute imports to drive share price

**Favourable policies for leading domestic players, like Weigao, will allow them to gain market share.**

15 May 2020

Our chart in “analysis” suggests that release of policy encouraging domestic brands to substitute imports can drive the share price. In Aug 2018, the State Council assigned National Medical Pharmaceutical Administration, National Health Commission, National Healthcare Security Administration to promote domestic brands substitution imports. The share price reacted positively after that. In Jul 2019, the State Council issued “Reform of high value medical consumables industry governing”. The policy stated that hospitals are not allowed to mark up over procurement cost when selling high value medical consumables. As a result, medical consumables became a cost item instead of profit item, thus encouraging hospitals to go for domestic brands as they are cheaper. This is another policy encouraging the substitution of imports with domestic brands. Its share price reacted strongly after that. Going forward, we believe there will be more similar policy announcements, as the government wants to save money for hospitals and public medical insurance programmes. We estimate c.30% of Weigao’s sales will benefit from this.

**Policy announcements drive share price**



**CF 3: Turnaround of interventional devices business**

**The company acquired interventional products business in late Jan 2018 for US\$844m (Argon Medical Devices).**

28 Dec 2020

The company acquired the interventional products business in late Jan 2018 for US\$844m (Argon Medical Devices). Its segmental loss were Rmb103m in 2018A and Rmb79m in 2019A. We believe it can turn around in 2020 to generate segmental profit of Rmb17m in 2020F and Rmb194m in 2021F. This is driven by the sales growth in Europe and Middle East, also operating leverage to lower fixed costs as percentage of sales. Argon is a growth driver in the long term because of a) its good product quality, as evidenced by its significant market share in the US (e.g. 23-65% in the US biopsy instruments market); and b) increase in the sales of Argon’s products in China through its sales network (covering >40% and >10% of top-tier and mid-tier hospitals respectively). We believe turnaround of this business can drive share price.

**Share Price Vs. Interventional Product Segment Revenue**



**CF 4: Parent company to inject assets into the company**

**Implementation of full circulation of H shares in Aug 2018 is an incentive for parent company to inject assets into the company in the long run.**

15 May 2020

## Critical Equity Factors

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Entities registered in Mainland China, like the parent company, were only able to hold domestic shares that were not tradeable on the Hong Kong Stock Exchange in the past. Nowadays, those shares are now tradable on the Hong Kong Stock Exchange. Going forward, if the parent injects assets for new shares in the company, the shares will be tradable. As such, the parent has more incentives to inject assets. In light of the efforts of the company and its parent on the full circulation of H shares, we believe there are plans for asset injections in the future. In fact, the parent company is running a lot of healthcare businesses that could be asset-injection candidates (see: <http://www.weigaoholding.com/> )

## About Company

## VALUATION

### PE:

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### Where we differ

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### Key Risks to Our View:

Price cuts imposed by provincial governments for regional volume-based procurement.

## PROFILE

### At a glance

Issued Capital (m shrs)	4,552
Major Shareholders (%)	
Weigao Holding Co Ltd	46.4
Free Float (%)	53.6
GICS Industry: Health Care / Health Care Equipment & Service	

Established in 1988 and listed in Hong Kong Stock Exchange in 2004, the company is a leading player in China's medical consumables industry with significant market share in different segments, including devices for blood collection and management, medical testing consumables and anaesthesia & surgery consumables.

### Business Segment

- Revenue Drivers:
  - Sales breakdown: Medical device products: 46%, Orthopaedic products: 18%, Interventional Products: 14%, Pharma packaging 15%, Blood management 7%
  - Sales drivers: Substituting imports, launch of new products, potential injection from parent company.
- Cost Structure:
  - Raw material for consumables, labour cost, depreciation.
- Competition Position:
  - Leader in low value medical consumables and interventional devices.

### Balance sheet

With net cash of Rmb2.9bn as of June 2021, its balance sheet remains healthy.

### Environmental & Social & Governance

**Environmental:** In 2018, the company constructed new sewage treatment facilities that could process 300 tonnes of sewage a day to ensure that its waste-water quality meets authorities' requirements.

**Social:** Argon, a subsidiary of the company headquartered in the US, has product quality control systems that meet the US and Canada's standards. Such international exposure should enhance the overall quality control system of the group. There were no identified violations that were related to products and none of those that would significantly impact the company in 2018.

**Governance:** There was no corruption-related legal action taken against the company and its employees in 2018.

### Key Assumptions

## About Company

<b>FY Dec</b>	<b>2018A</b>	<b>2019A</b>	<b>2020A</b>	<b>2021F</b>	<b>2022F</b>
Revenue growth %	40.0	17.9	9.3	19.6	20.6
Gross margin %	61.2	62.7	56.9	59.0	59.5
SG&A % in sales	41.8	40.2	35.9	37.5	37.7

Source: Company, DBS HK

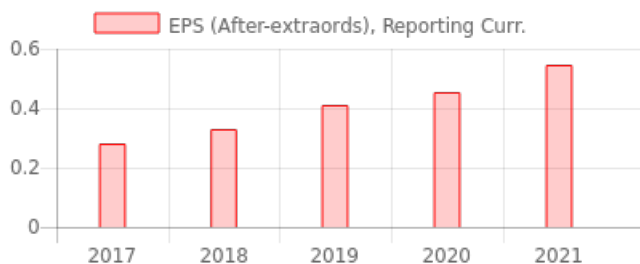
**Segmental Breakdown (RMB m)**

<b>FY Dec</b>	<b>2018A</b>	<b>2019A</b>	<b>2020A</b>	<b>2021F</b>	<b>2022F</b>
<b>Revenues (RMB m)</b>					
Medical device products	4,826	5,414	5,749	6,726	7,869
Orthopaedic products	1,181	15,56	1,748	2,272	2,954
Interventional products	1,444	1,656	1,612	1,773	2,039
Pharma packaging	956	1,281	1,694	2,117	2,647
Blood management	402	458	544	679	849
Others	0	0	0	0	0
<b>Total</b>	<b>8,809</b>	<b>10,364</b>	<b>11,345</b>	<b>13,567</b>	<b>19,761</b>
<b>Operating profit (RMB m)</b>					
Medical device products	956	1,101	1,071	1,253	1,466
Orthopaedic products	354	511	529	688	894
Interventional products	(103)	(79)	26	177	204
Pharma packaging	328	471	555	693	867
Blood management	52	63	74	93	116
Others	62	67	64	64	64
<b>Total</b>	<b>1,586</b>	<b>2,066</b>	<b>2,320</b>	<b>2,969</b>	<b>3,611</b>
<b>Operating profit Margins (%)</b>					
Medical device products	19.8	20.3	18.6	18.6	18.6
Orthopaedic products	30.0	32.8	30.3	30.3	30.3
Interventional products	(7.1)	(4.8)	1.6	10.0	10.0
Pharma packaging	34.3	36.8	32.8	32.8	32.8
Blood management	12.9	13.7	13.7	13.7	13.7
Others	N/A	N/A	N/A	N/A	N/A
<b>Total</b>	<b>18.7</b>	<b>20.5</b>	<b>20.4</b>	<b>21.9</b>	<b>22.1</b>

Source: Company, DBS HK

## Company Ratios

**EPS (After-extraordinaries)**



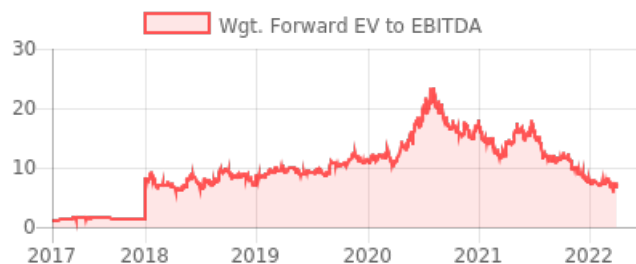
**Wgt. Forward P/E (1066.HK)**



**Wgt. Forward P/B (1066.HK)**



**Wgt. Forward EV to EBITDA**



**Wgt. Forward Dividend Yield**





**FORECASTS AND VALUATION (CNY, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Revenue	8,809	10,384	11,345	13,567	16,357
EBITDA	2,451	3,136	3,251	3,663	4,332
Pre-tax Profit	1,775	2,252	2,496	3,012	3,645
Net Profit	1,473	1,850	2,030	2,446	2,960
Net Pft (Pre Ex.)	1,473	1,850	2,030	2,446	2,960
Net Pft Gth (Pre-ex) (%)	17.3	25.6	9.7	20.5	21.0
EPS (HKD)	0.375	0.462	0.539	0.670	0.813
EPS Pre Ex. (HKD)	0.375	0.462	0.539	0.670	0.813
EPS Gth Pre Ex (%)	17.3	25.6	9.7	20.5	21.0
Diluted EPS (HKD)	0.374	0.462	0.537	0.668	0.810
Net DPS (HKD)	0.116	0.135	0.074	0.200	0.243
BV Per Share (HKD)	3.69	4.04	4.64	5.38	5.96
PE (x)	33.1	26.4	24.0	20.0	16.5
PE Pre Ex. (x)	33.1	26.4	24.0	20.0	16.5
P/Cash Flow (x)	22.0	21.0	18.1	17.5	17.1
EV/EBITDA (x)	20.5	15.9	14.3	12.2	10.1
Net Div Yield (%)	0.9	1.1	0.6	1.5	1.8
P/Book Value (x)	3.4	3.0	2.8	2.5	2.2
Net Debt/Equity (x)	0.1	0.0	0	0	0
ROAE (%)	10.6	12.1	12.0	13.1	14.3

**INCOME STATEMENT (CNY, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Revenue	8,809	10,384	11,345	13,567	16,357
Cost of Goods Sold	(3,420)	(3,870)	(4,888)	(5,563)	(6,625)
<b>Gross Profit</b>	<b>5,389</b>	<b>6,514</b>	<b>6,457</b>	<b>8,005</b>	<b>9,733</b>
Other Opng (Exp)/Inc	(3,534)	(4,074)	(3,906)	(4,925)	(6,004)
Operating Profit	1,856	2,440	2,552	3,080	3,729
Other Non Opg (Exp)/Inc	0.000	0.000	0.000	0.000	0.000
Associates & JV Inc	33.25	81.10	9.17	9.17	9.17
Net Interest (Exp)/Inc	(113.6)	(268.6)	(64.69)	(77.36)	(93.27)
Exceptional Gain/(Loss)	0.000	0.000	0.000	0.000	0.000
<b>Pre-tax Profit</b>	<b>1,775</b>	<b>2,252</b>	<b>2,496</b>	<b>3,012</b>	<b>3,645</b>
Tax	(258.4)	(327.1)	(345.6)	(420.4)	(509.0)
Minority Interest	(43.85)	(75.30)	(120.3)	(144.9)	(175.6)
Preference Dividend	0.000	0.000	0.000	0.000	0.000
<b>Net Profit</b>	<b>1,473</b>	<b>1,850</b>	<b>2,030</b>	<b>2,446</b>	<b>2,960</b>
Net Profit before Except.	1,473	1,850	2,030	2,446	2,960
EBITDA	2,451	3,136	3,251	3,663	4,332
<b>Growth</b>					
Revenue Gth (%)	40.0	17.9	9.3	19.6	20.6
EBITDA Gth (%)	40.9	27.9	3.7	12.6	18.3
Opg Profit Gth (%)	25.7	31.5	4.6	20.7	21.1
Net Profit Gth (Pre-ex) (%)	17.3	25.6	9.7	20.5	21.0
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	61.2	62.7	56.9	59.0	59.5
Opg Profit Margin (%)	21.1	23.5	22.5	22.7	22.8
Net Profit Margin (%)	16.7	17.8	17.9	18.0	18.1
ROAE (%)	10.6	12.1	12.0	13.1	14.3
ROA (%)	7.2	7.3	7.6	8.4	9.2
ROCE (%)	9.0	9.6	9.6	10.8	11.8
Div Payout Ratio (%)	31.0	29.3	13.8	30.0	30.0
Net Interest Cover (x)	16.3	9.1	39.4	39.8	40.0

**BALANCE SHEET (CNY, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Net Fixed Assets	4,468	4,497	4,695	4,873	5,032
Invt in Associates & JVs	970.7	1,056	1,069	1,069	1,069
Other LT Assets	7,830	8,185	7,456	7,205	6,954
Cash & ST Invt	4,384	4,992	6,324	8,845	10,182
Inventory	1,137	1,246	1,504	1,715	1,955
Debtors	4,104	4,719	5,928	6,698	8,038
Other Current Assets	1,092	1,658	369.1	369.1	369.1
<b>Total Assets</b>	<b>23,987</b>	<b>26,353</b>	<b>27,345</b>	<b>30,774</b>	<b>33,599</b>
ST Debt	96.30	914.2	297.9	307.9	317.9
Creditor	659.6	798.6	1,406	1,603	1,827
Other Current Liab	2,571	2,870	2,795	3,136	3,538
LT Debt	5,093	4,435	3,001	2,951	2,901
Other LT Liabilities	376.4	342.9	1,454	1,454	1,454
Shareholder's Equity	14,515	16,180	17,545	19,722	21,785
Minority Interests	676.3	811.4	845.1	1,600	1,776
<b>Total Cap. &amp; Liab.</b>	<b>23,987</b>	<b>26,353</b>	<b>27,345</b>	<b>30,774</b>	<b>33,599</b>
Non-Cash Wkg. Capital	3,103	3,954	3,600	4,044	4,996
Net Cash/(Debt)	(804.9)	(357.7)	3,025	5,585	6,963
Debtors Turn (avg days)	161.3	155.1	171.3	169.8	164.4
Creditors Turn (avg days)	73.9	81.8	95.9	110.1	103.8
Inventory Turn (avg days)	124.1	133.6	119.6	117.7	111.0
Asset Turnover (x)	0.4	0.4	0.4	0.5	0.5
Current Ratio (x)	3.2	2.8	3.1	3.5	3.6
Quick Ratio (x)	2.6	2.1	2.7	3.1	3.2
Net Debt/Equity (x)	0.1	0.0	0	0	0
Net Debt/Equity ex MI (x)	0.1	0.0	cash	cash	cash
Capex to Debt (%)	15.3	18.2	27.7	15.4	15.6

**CASH FLOW STATEMENT (CNY, M)**

<b>FY Dec</b>	<b>FY2018A</b>	<b>FY2019A</b>	<b>FY2020A</b>	<b>FY2021F</b>	<b>FY2022F</b>
Pre-Tax Profit	1,775	2,252	2,496	3,012	3,645
Dep. & Amort.	562.6	615.0	690.7	573.4	593.6
Tax Paid	(240.8)	(473.7)	(381.5)	(420.4)	(509.0)
Assoc. & JV Inc/(loss)	(33.25)	(81.10)	(9.17)	(9.17)	(9.17)
Chg in Wkg.Cap.	71.04	(248.7)	(687.9)	(443.9)	(952.9)
Other Operating CF	82.37	258.3	588.5	77.36	93.27
<b>Net Operating CF</b>	<b>2,217</b>	<b>2,322</b>	<b>2,697</b>	<b>2,789</b>	<b>2,861</b>
Capital Exp.(net)	(794.8)	(971.7)	(914.6)	(501.0)	(502.0)
Other Invts.(net)	0.000	(289.8)	(7.97)	0.000	0.000
Invts in Assoc. & JV	(5,420)	(23.86)	0.465	0.000	0.000
Div from Assoc & JV	0.000	0.000	0.000	0.000	0.000
Other Investing CF	127.8	(51.89)	1,345	136.6	164.7
<b>Net Investing CF</b>	<b>(6,087)</b>	<b>(1,337)</b>	<b>423.2</b>	<b>(364.4)</b>	<b>(337.3)</b>
Div Paid	(217.9)	(711.4)	(701.3)	(733.9)	(888.1)
Chg in Gross Debt	4,059	(5.22)	(1,887)	(40.00)	(40.00)
Capital Issues	0.000	0.000	0.000	1,084	0.000
Other Financing CF	33.30	151.4	794.7	(214.0)	(258.0)
<b>Net Financing CF</b>	<b>3,875</b>	<b>(565.2)</b>	<b>(1,794)</b>	<b>95.76</b>	<b>(1,186)</b>
Currency Adjustments	21.22	8.48	(53.94)	0.000	0.000
Chg in Cash	25.83	428.2	1,272	2,520	1,337
Opg CFPS (HKD)	0.546	0.643	0.898	0.886	1.05
Free CFPS (HKD)	0.362	0.338	0.473	0.627	0.648

**RECOMMENDATION DEFINITION**

DBS Group Research recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

Sources for all charts and tables are DBS HK unless otherwise specified.

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## Target Price &amp; Ratings History



#	Date of Report	Closing Price	12-m Target Price	Rating
1	31 Aug'21	13.18	17.70	BUY

Analysts: Mark Kong

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