

Shandong Weigao

Fundamental is still strong

BUY (Unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	1,095.1	1,514.4	2,088.8	2,916.0	3,820.0
Net Profit (RMBm)	308.1	482.4	751.5	1,087.1	1,401.2
EPS (RMB)	0.312	0.485	0.698	1.010	1.302
EPS Δ%	76.5	55.1	44.1	44.7	28.9
P/E (x)	38.0	24.5	17.0	11.8	9.1
P/B (x)	9.2	5.3	3.9	3.1	2.5
EV/EBITDA (x)	36.0	21.0	15.8	10.2	7.4
Yield (%)	0.8	1.2	1.7	2.5	3.2
ROE (%)	30.4	25.4	25.7	28.5	29.2
ROCE (%)	20.2	22.4	22.0	25.5	26.4
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

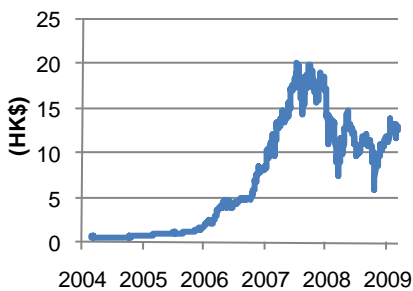
Source: SBI E2Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+3.3	+46.3	+137.7
Actual price changes (%)	+2.7	+21.8	+45.2

	09F	10F	11F
Consensus EPS (RMB)	0.624	0.849	1.100
Previous forecasts (RMBm)	2,297.6	3,216.9	
Previous EPS (RMB)	0.717	1.051	

Price Chart



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needles in 4Q grew 37.8% YoY to RMB81.7m. This was achieved with a 14.3% YoY drop in volume, but 75.0% YoY surge in ASP. Management indicated that this was a temporary sales strategy given the conditions at the time and since 1Q FY12/08A product mix has already begun to shift back to normal percentage levels.

Blood purification kit would be new growth driver. Weigao's scheduled launch of blood purification kits at the beginning of 2009 is on track. The company has an annual capacity of 1.7msets. The management re-iterated confidence in its targeted revenue of RMB100.0m+ from this product in 2009.

Medtronic JV going well. Weigao obtained all necessary regulatory proposals in Dec 2008 for Medtronic to become a 15%-shareholder of the company. For 4Q FY12/08A, this JV contributed RMB8.4m profit to Weigao's

Ticker:	8199.HK	12 mth range:	HK\$5.76-14.8
Price:	HK\$13.5	Market cap:	US\$1,862.8m
Target:	HK\$15.0(+11%)	Daily t/o, 3 mth:	US\$1.3m
		Free float %:	38.2%

Key points:

- * FY12/08A net profit RMB482.4m, up 56.5% YoY and in line with estimates
- * Strong 4Q margin of 59.2% due to shift in sales strategy during the quarter, to mitigate receivables risk from customers. We expect this to moderate back to more normal levels in FY12/09F
- * Launch of blood purification kits on track. Target revenue of RMB100.0m+ for FY12/09F
- * Medtronic JV for distribution of orthopaedic products up and running. Contributed RMB8.4m in 4Q despite several one-off establishment costs
- * Marketing costs and competition deflated JWMS contribution. Outlook somewhat uncertain due to potential internal competition for resources
- * Overall fundamentals still strong, poised to benefit from Chinese government's investment into healthcare over the next few years. Maintain BUY call, target price HK\$15.00, representing 18.9x FY12/09F P/E

FY12/08 results in line. Weigao's FY12/08A revenue was up 38.3% YoY to RMB1,514.4m while net profit came in at RMB482.4m, up 56.5% YoY and in line with our estimates. Upside surprise came from a strong gross margin, which improved to 50.1% for full year FY12/08A (47.1% in for 9M FY12/08A and 45.7% for FY12/07A). Though we had anticipated revenue growth in 4Q to moderate (owing to inventory build up by its customers in 3Q and general weak China economy in 4Q) the actual top line of RMB370.7m (up 16.7% YoY) was lower than our expectations. However, a 9.7pcp expansion to 59.2% in gross margin helped 4Q net profit increased 33.6% YoY to RMB154.8m. Net margin in 4Q FY12/08A increased 5.3pcp to 41.8%.

Why strong margin in 4Q? We were as surprised as the street on the company's 59.2% quarterly gross margin even after factoring in positive impact from lower raw material costs. Management explained that due to the tighter credit conditions in 4Q FY12/08, company sort to mitigate receivables risk by reducing sales of low margin products to customers which, in the management's view, have a high receivables risk. This shifted of product mix towards higher margin products resulted in higher blended gross margin. For example, Weigao's sales of medical

consolidated accounts. The management said that the result is ahead of their initial expectations given the many one-off costs associated with establishing the JV. They expect more contribution would start from 2Q FY12/09F.

Marketing costs deflated JWMS contribution. Contribution from JWMS in 4Q FY12/08A dropped 74.9% YoY to RMB5.6m (vs SBI E2 estimate of RMB25.7m). Management indicated that though top line achieved 30.0%+ YoY growth. The YoY decrease in net profit is due to increased competition in China's DES market, which negatively affected gross margins, as well as special marketing expenses related to overseas promotion. Our interpretation of the situation is that JWMS is the key cash cow of Weigao's partner, Biosensors, in this 50/50 JV, and the SG-listed company has been over aggressive in promoting the Excel Stent in overseas markets to support the ramp up its own BioMatrix™ Stent. We think this potentially poses competition for internal resources, which may harm the development outlook of JWMS. Weigao's management is also not satisfied with the performance of JWMS and they are presently exploring options including potential increasing its stake in the JV.

Looking to acquire. After including the proceeds from the Medtronic share sale, Weigao was in a net cash position of RMB767.0m at end-FY12/08A. Management has recognized potential of China's medical devices market and has indicated that it is on the look out for complementary M&A targets (both domestically and overseas) to enhance its product portfolio and/or expand its geographical reach. However, they also stressed that they will adopt a cautious approach in selecting the M&A targets and the purchase valuation given current market environment.

Minor adjustments in estimates. We have moderately adjusted our FY12/09F-11F net profit estimate downward by between 2.0-4.0%. For FY12/09F, we are now looking for revenues of RMB2,088.8m (previously RMB2,297.6m) and net profit of RMB751.5m (previously RMB771.7m). Our adjustments take into consideration: 1) lesser contribution from JWMS; 2) slower growth in its medical needles segment and 3) a slightly slower ramp up in the Medtronics JV.

Maintain BUY call, but share price overhang exists. With solid leadership position and a penetrating distribution network, Weigao's fundamentals remain strong, poised to benefit from the Chinese governments' investments into healthcare over the next few years. That said, we think that there may be an overhang on its share price short term with the uncertainty surrounding the possible windup of one of its significant shareholders, Atlantis Investment Management (Atlantis). Atlantis currently holds 13.8% of the company's H-shares. We maintain our BUY call on the counter with target price HK\$15.0 representing 18.9x FY12/09F P/E.

Table 1: 4QFY12/08A results

3 months to Dec	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	EPS (RMB)	DPS (RMB)
4Q FY08	370.7	219.3	59.2	173.7	8.6	154.8	0.16	0.09
3Q FY08	445.9	211.8	47.5	145.8	6.3	136.9	0.14	-
QoQ (%)	(16.9)	3.5		19.1		13.1	14.2	-
4Q FY07	317.7	157.2	49.5	115.4	n/a	115.9	0.12	0.06
YoY (%)	16.7	39.5		50.5		33.6	33.3	47.5

Source: Company data

Table 2: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	1,095.1	1,514.4	2,088.8	2,916.0	3,820.0
Cost of sales	(594.8)	(756.1)	(1,014.4)	(1,387.3)	(1,802.0)
Gross profit	500.3	758.2	1,074.4	1,528.7	2,017.9
Other net (loss)/income	31.5	78.1	103.3	131.4	127.8
Selling and distribution costs	(152.7)	(208.7)	(277.6)	(392.4)	(502.6)
Administrative expenses	(88.0)	(137.7)	(181.4)	(211.2)	(272.9)
Operating profit	291.1	489.9	718.7	1,056.5	1,370.2
Financial costs	(17.9)	(30.2)	(4.2)	(4.2)	-
Share of loss of a jointly controlled entity	59.0	56.0	65.3	58.7	52.9
Share of loss of an associate	-	8.4	59.9	123.6	197.8
Pre-tax profit	332.1	524.1	839.7	1,234.7	1,620.9
Tax	(2.7)	(39.0)	(81.1)	(136.8)	(205.5)
Minority interests	(21.2)	(2.7)	(7.2)	(10.8)	(14.2)
Net profit	308.1	482.4	751.5	1,087.1	1,401.2

Source: Company data, SBI E2-Capital

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