

Shandong Weigao

Stock slightly ahead of fundamentals

SELL (From HOLD)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	1,095.11	514.42	627.62	798.13	665.6
Net Profit (RMBm)	308.1	482.4	673.1	951.01	222.3
EPS (RMB)	0.312	0.485	0.625	0.884	1.136
EPS Δ%	76.5	55.1	29.1	41.3	28.5
P/E (x)	46.1	29.7	23.0	16.3	12.7
P/B (x)	11.2	6.5	5.3	4.2	3.4
EV/EBITDA (x)	43.6	25.9	23.0	15.5	11.6
Yield (%)	0.6	1.0	1.3	1.8	2.3
ROE (%)	30.4	25.4	24.4	27.8	28.6
ROCE (%)	20.2	22.4	19.9	23.7	24.6
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

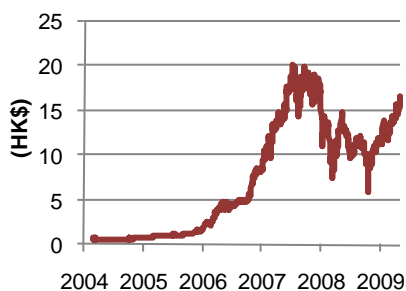
Source: SBI E2Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+0.4	-2.5	+79.7
Actual price changes (%)	+15.5	+23.4	+20.6

	09F	10F	11F
Consensus EPS (RMB)	0.628	0.848	1.096
Previous forecasts (RMBm)	751.5	1,087.1	1,401.2
Previous EPS (RMB)	0.698	1.010	1.302

Price Chart



Kennedy Tsang / Helena Qiu

(852) 2533 3713/3709

kennedytsang/ helenaqiu@sbi2capital.com

overseas travelling etc). Management expects the SG&A costs, as a percentage of revenue, to remain high for next two quarters.

Chinese DES market is still very competitive. For IQ FY12/09A, the contribution of JW Medical increased 63.4% YoY and 293.0% QoQ to RMB22.1m. Management indicate that this better than expected growth was partially because of the delayed consumption from 4Q 2008. We remain cautious on the outlook of JW Medical as the Chinese DES market is still competitive going forward given: 1) the vicious price competition from domestic suppliers; 2) overseas suppliers launching new DES product in China. In addition, we think that the continuing stalemate between Weigao and Biosensors regarding the majority ownership of JW Medical may hold back the JV's overall development plans.

Ticker:	8199.HK	12 mth range:	HK\$5.76-17.46
Price:	HK\$16.36	Market cap:	US\$2,258.9m
Target:	HK\$14.2 (-13%)	Daily t/o, 3 mth:	US\$2.2m
		Free float %:	30.8%

Key points:

- * IQ FY12/09 revenue increased 30.1% YoY to RMB394.3m and net profit up 38.2% YoY to RMB105.6m
- * Stricter credit control and competition from OEM company affect growth (bottom line 50%+ YoY growth for past 4 years)
- * SG&A cost would remain high for next two quarters for encouraging payback of account receivables
- * Although IQ DES contribution is good, Chinese DES market remain very competitive
- * Plan to expand to low to middle level consumer market as a long term market expansion strategy and capture government medical investment in rural areas
- * JV with Medtronic contribution is still small with RMB6.4m
- * Stock price run slightly ahead of fundamentals. Downgrade to SELL (from HOLD) with revised target price HK\$14.20.

Update. For IQ FY12/09A, revenue increased 30.1% YoY and 6.4% QoQ to RMB394.3m while net profit increased 38.2% YoY and decreased 31.7% QoQ to RMB105.6m. The gross margin widened 1.5pcp YoY and dropped 11.1pcp QoQ to 48.1% with the net profit up 1.6pcp YoY and down 15.0pcp QoQ to 26.8%. Both revenue and net profit were slightly lower than our expectation.

Stricter credit control affects the growth. Given the current economic and operating climate, Weigao is still maintaining their conservative credit strategy (which began in 4Q FY12/08), to ensure a reasonable period of account receivables days. At the same time, it is also facing pressure from OEM companies, a few of which have switched from focusing on overseas market to domestic market. As a result, net profit has moderated (bottom line 50%+ YoY growth for past 4 years).

SG&A cost would remain high for next two quarters. For IQ FY12/09A, the selling and distribution cost increased 46.5% YoY as Weigao gave special rebates to its customers to encourage payback of account receivables. Administration cost increased 77.9% YoY was higher than expected. Main reason was the increased R&D expenditure (up 53.6% YoY to RMB17.7m), while we also suspect there was a significant increase in miscellaneous administration costs due to the cooperation with Medtronic at the corporate level (compliance,

Plan to expand low to middle level consumer market. Weigao plans to do some M&A to penetrate the low to middle level consumer market as a long-term development strategy. Although this market is currently more competitive and less profitable than high level consumer market, the government investment in medical insurance and people's increasing affordability would make this market very attractive in the future.

JV with Medtronic contribution is still small. For 1Q FY12/09A, this JV contributed decreased 24.0% QoQ to RMB6.4m, which was affected by: 1) Chinese New Year; 2) higher than expected administration expenses due to the nature of the sino-foreign JV also erode some profit. Although management expects more contribution would start from 2Q FY12/09F, we think that near term, relatively high administration costs will continue to weigh down profits, until the JV begins to develop operating scale.

Outbreak of swine flu will be negative for Weigao. Management said that they did not see any affect from Swine flu now. But if there were breakout of swine flu in China, it would greatly impact Weigao's business because people would be really reluctant to go to hospital (80%+ Weigao's product is used in hospitals).

Capex. Management guided capex for 2009 would be around RMB150m.

Stock price running ahead of fundamentals, Downgrade to SELL (from HOLD). Factoring in the company's current operating environment, we revised down our net profit forecast to RMB673.1m (from RMB751.5m) for FY12/09F and RMB951.0m (from RMB1,087.1m) for FY12/10F. While overall outlook remains positive, we think that for the next one to two quarters, the company's growth may moderate from previous high levels as it navigates the current economic and operating climate and face increase competition from OEMs. Upside for the company appears well priced into the current stock price while downside risks are increasing. We think current stock price has run slightly ahead to the company's fundamentals and downgrade our call on the counter to SELL (from HOLD). Our DCF-derived target price HK\$14.20 (WACC 16.0% with 3% terminal growth) represents 20.0x FY12/09F and 14.1x FY12/10F P/E. The counter is currently trading at 23.0x FY12/09F and 16.3x FY12/10F P/E based on our estimates.

Table 1: 1Q FY12/09A results

3 months to Apr	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	EPS (RMB)
1Q FY09	394.3	189.5	48.1	116.3	10.1	105.6	0.098
4Q FY08	370.7	219.3	59.2	173.7	8.6	154.8	0.160
QoQ (%)	6.4	(13.5)		(33.0)		(31.7)	(38.8)
1QFY08	303.0	141.2	46.6	81.5	7.1	76.4	0.077
YoY (%)	30.1	34.2		42.8		38.2	27.3

Source: Company data

Table 2: revenue breakdown

	1Q FY12/09 (RMBm)	% of total	4Q FY12/08 (RMBm)	QoQ (%)	1Q FY12/08 (RMBm)	YoY (%)
Self-produced products						
Consumables						
Infusion sets	106.5	27.0	97.0	9.8	75.2	41.7
Syringes	74.4	18.9	59.3	25.5	58.1	28.0
Needles	69.6	17.7	81.7	(14.8)	43.8	58.9
Blood bags	32.2	8.2	34.6	(6.9)	25.3	27.6
Blood sampling products	11.4	2.9	6.0	90.0	8.1	40.3
Pre-filled syringes	9.5	2.4	4.4	115.9	5.6	70.3
Dental & anaesthetic	4.6	1.2	4.1	12.2	3.8	21.3
Other consumables	17.5	4.4	12.5	40.0	12.1	44.8
Subtotal for consumables	325.7	82.6	299.6	8.7	232.0	40.4
Orthopaedic products	28.8	7.3	34.7	(17.0)	35.8	(19.6)
Dialysis products	9.9	2.5	4.2	135.7	5.3	86.3
PVC granules	11.3	2.9	13.5	(16.3)	15.1	(25.5)
Others			0.2	n/a		
Trading						
Medical instruments	13.8	3.5	14.5	(4.8)	12.1	14.1
Other products	4.8	1.2	4.3	11.6	2.7	74.3
Total	394.3	100.0	370.7	6.4	303.0	30.1

Source: Company data

Table 3: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	1,095.1	1,514.4	2,027.6	2,798.1	3,665.6
Cost of sales	(594.8)	(756.1)	(1,055.1)	(1,427.9)	(1,855.9)
Gross profit	500.3	758.2	972.5	1,370.2	1,809.7
Other net (loss)/income	31.5	78.1	118.7	131.4	127.8
Selling and distribution costs	(152.7)	(208.7)	(294.8)	(409.8)	(525.9)
Administrative expenses	(88.0)	(137.7)	(175.3)	(199.4)	(257.5)
Operating profit	291.1	489.9	621.0	892.4	1,154.0
Financial costs	(17.9)	(30.2)	(4.2)	(4.2)	0.0
Share of loss of a jointly controlled entity	59.0	56.0	73.3	65.9	59.3
Share of loss of an associate	-	8.4	52.4	121.5	194.4
Pre-tax profit	332.1	524.1	742.5	1,075.7	1,407.8
Tax	(2.7)	(39.0)	(64.9)	(115.5)	(173.1)
Minority interests	(21.2)	(2.7)	(4.5)	(9.2)	(12.3)
Net profit	308.1	482.4	673.1	951.0	1,222.3

Source: Company data, SBI E2-Capital

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