

Shandong Weigao

Development on the road

HOLD (Unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	1,095.11	514.41	986.32	724.03	568.4
Net Profit (RMBm)	308.1	482.4	674.7	952.41	224.2
EPS (RMB)	0.312	0.485	0.627	0.885	1.137
EPS Δ%	76.5	55.1	29.4	41.2	28.5
P/E (x)	53.5	34.5	26.6	18.9	14.7
P/B (x)	12.9	7.5	6.1	4.9	3.9
EV/EBITDA (x)	50.6	30.2	26.0	17.9	13.2
Yield (%)	0.5	0.9	1.1	1.5	2.0
ROE (%)	30.4	25.4	24.3	27.8	28.8
ROCE (%)	20.2	22.4	20.7	24.3	25.9
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

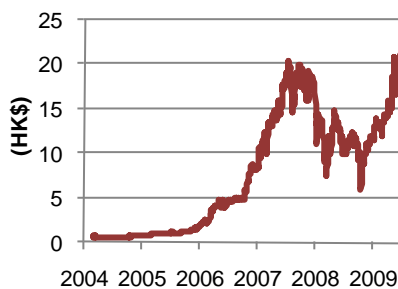
Source: SBI E2Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-14.6	-1.7	+73.5
Actual price changes (%)	+1.2	+17.7	+66.5

	09F	10F	11F
Consensus EPS (RMB)	0.609	0.825	1.073
Previous forecasts (RMBm)	673.1	951.0	1,222.3
Previous EPS (RMB)	0.625	0.884	1.136

Price Chart



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Xinqiao Hospital in Chongqing City, which has 1800 bed and 600,000 patient a year, for building the dialysis center. According to the agreement, Weigao will buy 100 dialysis machines for Xinqiao hospital for building the dialysis center and in return, Xinqiao hospital will buy product from Weigao in amount of RMB35.0m a year for 10 years. Weigao is currently talking with other hospital for the corporation opportunity as well. We think this corporation method would provide strong support for the sales of Weigao's blood purification kit.

DES contribution beat our expectation. Given the current competitive market condition, Weigao's DES business is better than our expectation with a 29.2% YoY and 10.2% QoQ growth in net profit contribution based on vicious competitive environment. Although we remain a conservative view on future contribution from DES, Weigao's performance does show its capability of handling the market competition.

Ticker:	8199.HK	12 mth range:	HK\$5.76-21.70
Price:	HK\$18.98	Market cap:	US\$2,620.6m
Target:	HK\$19.6 (+3%)	Daily t/o, 3 mth:	US\$4.0m
		Free float %:	30.8%

Key points:

- * 2Q FY12/09 revenue increased 21.6% YoY to RMB479.8m and net profit up 33.0% YoY to RMB152.0m
- * Consumable product would still be key growth driver, which would be mainly driven by the improvement in product mix
- * Outlook of sale of blood purification kits is very positive and Weigao signed contract with Xinqiao hospital for RMB35m product sales a year
- * JW medical contribution is better than expectation although the market competition remain vicious
- * Development from Medtronic JV is slower than expectation and Weigao need more time to work with Medtronic
- * The time to move to HKEx Main Board is uncertain
- * Maintain HOLD call with new DCF derived target price HK\$19.6

Update. 2Q FY12/09A results are in line with our expectation. Revenue increased 21.6% YoY to RMB479.8m while the net profit increased 33.0% YoY to RMB152.0m. The revenue growth was mainly driven by 32.6% YoY growth in consumable medical devices. The gross margin increased 3.0 pcp YoY to 50.1% due to the scale effect and the net margin widened 2.8 pcp YoY.

Consumable product would still be strong support of the growth. For 2Q FY12/09A, the sales of consumable medical device product increased 32.6% YoY to RMB\$397.7m. The management is confidence of keeping a 30% YoY growth going forward, which would be mainly driven by improving product mix in both top tier hospitals and lower end hospitals. The average ASP of infusion set and medical needles increased 44.0% and 72.7% YoY respectively for 2Q FY12/09A. Management also indicates that it would be difficult to expand its network in lower end hospitals by acquisition as they would want because the valuation for the acquisition target would be too high under the current market.

The outlook of sales of blood purification kits is very positive. The sales of blood purification kit were RMB16.2m although the product was just officially launched in April 2009. The management said that it would not be difficult for Weigao to achieve its target sales of RMB100.0m for FY12/09F. In 2Q 2009, Weigao signed contract with

Still need time to work with Medtronic. For 2Q FY12/09A, the contribution of Medtronic JV decreased 52.7% QoQ to only RMB3.0m. Although management said that there was around RMB6.4m one off stock inventory provision, which would write back to the company in coming quarters, the current performance shows that Weigao still need more time to work with Medtronic. We still remain that Orthopaedic product would be the key long term growth driver for Weigao although we would expect the contribution for FY12/09F would be minimal.

The time move to HKEx Main Board is uncertain. Weigao has submitted the document to related regulators. However, as an H-share company, Weigao is still waiting for the approval from China Securities Regulatory Commission (CSRC) to move to HKEx main board. Given previous slow down in IPO in A share market, the approval for Weigao's application is delayed.

Maintain HOLD call with new target price of HK\$19.6. As we wrote in our email alert in 19 May 2009, we upgrade our call to HOLD from SELL based on the news that Shandong Weigao would be included in the MSCI Hong Kong Small Cap Index on 14 May. After we review our model, we revised our forecast slightly to RMB674.7m for FY12/09F (from 673.1m) and RMB952.4m (from 951.0m) for FY12/10F. Our new DCF-derived target price is HK\$19.6 (WACC 12.8% with 3% terminal growth) represents 27.5x FY12/09F and 19.5x FY12/10F P/E.

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)
2Q FY09	479.9	240.3	50.1	166.3	9.1	152.0	0.141
1Q FY09	394.3	189.5	48.1	116.3	10.1	105.6	0.098
QoQ (%)	21.7	26.8		43.0		44.0	44.0
2QFY08	394.8	185.9	47.1	123.1	7.4	114.3	0.115
YoY (%)	21.6	29.3		35.1		33.0	22.8

Source: Company data

Table 2: revenue breakdown

	2Q FY12/09 (RMBm)	% of total	1Q FY12/09 (RMBm)	QoQ (%)	2Q FY12/08 (RMBm)	YoY (%)
Self-produced products						
Consumables						
Infusion sets	132.0	27.5	106.5	24.0	91.7	44.0
Syringes	80.4	16.8	74.4	8.1	69.5	15.7
Needles	87.1	18.1	69.6	25.1	57.1	52.6
Blood bags	33.4	7.0	32.2	3.7	29.5	13.4
Blood sampling products	11.6	2.4	11.4	2.4	10.4	11.9
Pre-filled syringes	23.6	4.9	9.5	147.0	15.3	54.3
Dental & anaesthetic	5.1	1.1	4.6	9.2	4.8	4.7
Other consumables	24.5	5.1	17.5	39.7	21.7	12.9
Subtotal for consumables	397.7	82.9	325.7	22.1	299.9	32.6
Orthopaedic products	26.8	5.6	28.8	(7.0)	45.6	(41.3)
Dialysis products	16.2	3.4	9.9	63.6	7.4	120.2
PVC granules	13.0	2.7	11.3	15.7	24.8	(47.3)
Trading						
Medical instruments	13.9	2.9	13.8	0.7	9.1	52.5
Other products	12.3	2.6	4.8	157.4	8.0	52.6
Total	479.9	100.0	394.3	21.7	394.8	21.6

Source: Company data

Table 3: DCF valuation reference table

WACC	Terminal Growth				
	2.0%	3.0%	4.0%	5.0%	6.0%
11.8%	22.5	24.2	26.3	29.0	32.7
12.8%	18.4	19.6	21.0	22.8	25.2
13.8%	16.4	17.3	18.4	19.7	21.4
14.8%	14.7	15.4	16.3	17.3	18.6

Source: SBI E2-Capital

Table 4: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	1,095.1	1,514.4	1,986.3	2,724.0	3,568.4
Cost of sales	(594.8)	(756.1)	(1,005.3)	(1,350.9)	(1,755.3)
Gross profit	500.3	758.2	981.0	1,373.1	1,813.0
Other net (loss)/income	31.5	78.1	93.3	131.4	127.8
Selling and distribution costs	(152.7)	(208.7)	(295.9)	(394.9)	(499.5)
Administrative expenses	(88.0)	(137.7)	(172.4)	(195.0)	(237.6)
Operating profit	291.1	489.9	605.9	914.5	1,203.7
Financial costs	(17.9)	(30.2)	(4.8)	(4.2)	0.0
Share of loss of a jointly controlled entity	59.0	56.0	82.9	74.6	67.2
Share of loss of an associate	-	8.4	45.0	76.1	121.8
Pre-tax profit	332.1	524.1	729.1	1,061.1	1,392.6
Tax	(2.7)	(39.0)	(61.1)	(118.3)	(180.6)
Minority interests	(21.2)	(2.7)	6.7	9.7	12.1
Net profit	308.1	482.4	674.7	952.4	1,224.2

Source: Company data, SBI E2-Capital

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