

China / Hong Kong Company Guide

Yestar International

Version 5 | Bloomberg: 2393 HK Equity | Reuters: 2393.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 August 2016

BUY

Last Traded Price: HK\$3.53 (HSI : 22,933)

Price Target 12-mth: HK\$4.30 (22% upside) (Prev HK\$4.00)

Potential Catalyst: M&A

Analyst

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What's New

- **1H16 earnings rose 91% y-o-y to Rmb106m, much better than market expectations, due to strong sales of in-vitro diagnostic (IVD) devices**
- **Raise 16F/17F earnings by 9%/5% to reflect faster profit margin expansion**
- **Maintain BUY with a higher TP of HK\$4.3 premised on 1) 20% EPS CAGR in FY16F-18F; 2) potential acquisition to accelerate EPS CAGR**

Price Relative



Forecasts and Valuation

FY Dec (RMB m)	2015A	2016F	2017F	2018F
Turnover	2,455	3,149	3,504	3,925
EBITDA	360	582	661	776
Pre-tax Profit	280	464	553	669
Net Profit	163	254	302	366
Net Pft (Pre Ex)	163	254	302	367
Net Profit Gth (Pre-ex) (%)	61.3	56.4	18.6	21.2
EPS (RMB)	0.08	0.12	0.14	0.17
EPS (HK\$)	0.09	0.14	0.16	0.20
EPS Gth (%)	48.6	44.9	18.6	21.2
Diluted EPS (HK\$)	0.09	0.14	0.16	0.20
DPS (HK\$)	0.04	0.07	0.08	0.10
BV Per Share (HK\$)	0.48	0.58	0.68	0.79
PE (X)	37.7	26.0	21.9	18.1
P/Cash Flow (X)	37.1	19.8	14.2	13.2
P/Free CF (X)	41.6	21.0	14.9	13.7
EV/EBITDA (X)	16.8	11.0	9.4	7.7
Net Div Yield (%)	1.1	1.9	2.3	2.8
P/Book Value (X)	7.3	6.1	5.2	4.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	26.6	25.5	25.6	26.6
Earnings Rev (%)		8.55	5.23	New
Consensus EPS (RMB)		0.11	0.14	0.13
Other Broker Recs:		B: 3	S: 0	H: 0

Source of all data on this page: Company, DBSV, Thomson Reuters, HKEX

Dark horse in medical device industry

In-vitro diagnostic (IVD) device business to be the largest earnings driver ahead.

Yestar International (Yestar) is distributing IVD devices of Roche (ROG VX) in Shanghai, Jiangsu province and Anhui province. Roche is the largest IVD device maker globally (20-24% market share in the world, including China). This business contributes >50% of Yestar's earnings and is its top growth driver. We are confident on IVD prospects as we see a favorable trend. In order to control subsidies on drug consumption, the government requires public hospitals to lower their drug sales % of total revenue from c.40% to 30% by 2017. Hence, hospitals will offer more IVD services to compensate for lowering drug sales, which will drive the demand for IVD devices.

Increasing demand for IVD devices from mid-tier hospitals. In terms of hospitals, >50% of Yestar's coverage are mid tier hospitals. As top tier hospitals are generally over utilized, the government is directing more patients to mid tier hospitals, particularly patients suffering from chronic and minor diseases. With its high exposure to mid tier hospitals, Yestar will benefit.

More acquisitions to strengthen the medical device business.

Yestar will strengthen its IVD business through acquisitions. We believe Yestar is in talks with at least one M&A target.

Market share gain to drive the growth of medical film segment.

Other than the IVD business, Yestar has been producing medical film for Fujifilm (4901 JP) for over five years. The growth of this segment is mainly driven by market share gain of Fujifilm in the China market. Its demand is tied to the sales of Fujifilm's medical imaging devices. Fujifilm is promoting its medical imaging devices through aggressive pricing. Fujifilm & Yestar target to increase their market shares in medical film from 18% in 2014 to 35% before 2017.

Valuation:

TP of HK\$4.30 is pegged to healthcare sector's average (HK and Mainland China) 12-month forward PE of 31x.

Key Risks to Our View:

Deceleration in sales volume and potential ASP cuts of color photographic paper business.

At A Glance

Issued Capital (m shrs)	2,175
Mkt. Cap (HK\$m/US\$m)	7,678 / 990
Major Shareholders	
Hartono family (%)	71.1
Free Float (%)	28.9
3m Avg. Daily Val. (US\$m)	1.3
ICB Industry : Industrials / Support Services	

WHAT'S NEW**Strong earnings growth ahead driven by IVD devices business and potential acquisition**

1H16 earnings much better than market expectations: The y-o-y earnings growth of 91% was much better than 55-80% that was estimated by Yestar's positive profit alert on 1 Aug. The strong growth was due to:

- 1) Strong growth of IVD devices sales resulting from an expanded hospitals coverage, from 270 in 1H15 to 588 in 1H16. The revenue contribution from this segment increased from 24% in 1H15 to 49% in 1H16;
- 2) Gross margin expansion from 18% to 24.8% thanks to increasing contribution from IVD devices segment;
- 3) Increase of government grant from Rmb0.2m to Rmb14m;

With net debt to equity at 12% as at Jun 2016, Yestar's balance sheet remains healthy. The group did not declare an interim dividend (1H15: nil).

Raise 16F/17F earnings by 9%/5% to reflect faster profit margin expansion: Thanks to increasing contribution from higher margin products, the gross margin of IVD devices segment has increased from 25% in 2014 to 36.7% in 1H16. We believe this trend will continue on the back of new product launches. Thus, we revised up our gross margin assumption for IVD devices segment in FY16F/17F from 33.2%/33.7% to 36.8%/37.3%, resulting in an increase in FY16F/17F earnings by 9%/5%.

Strong EPS CAGR of 20% in FY16F-18F driven by IVD device business: We estimate IVD devices revenue contribution will surge from 36% in 2015 to 58% in 2018. Its growth will mainly be driven by:

- 1) Increasing demand from mid tier hospitals. Over half of the hospitals covered by Yestar are mid tier hospitals. As top tier hospitals are generally over utilized, the government is directing more patients to mid tier hospitals, particularly patients suffering from chronic and minor diseases. Thanks to its mid tier hospitals coverage, Yestar will benefit;
- 2) Launch of new products to capture opportunities arising from favorable policies. Distribution of Roche (ROG VX)'s

products contributes over 50% of Yestar IVD devices sales. Roche has been launching new products to capture new opportunities. For example, in view of the two-child policy, a lot of women are keen to have another child. Roche has launched a set of diagnostic products for testing of female's anti-Mullerian hormone which can reflect ovarian storage capacity, which is crucial for fertility. The product has been well received by the market as there are only a few of such products;

- 3) Stronger IVD devices demand due to hospitals' enthusiasm to offer more medical services. Thanks to price mark-up of 15% over procurement cost, public hospitals have been making money by selling drugs for decades. The government is now gradually removing the mark-up. To compensate for this, hospitals need to offer more medical services. IVD devices are necessities in providing medical services. Thus, increasing medical services will drive the demand for IVD devices;

EPS CAGR could accelerate thanks to potential acquisition:

On 30 May 2016, Yestar announced that it is in talks with a potential acquisition target. Based on the two acquisitions made in last two years, we observe that Yestar insisted that:

- 1) The target must be profitable;
- 2) The seller must provide a profit guarantee for earnings growth of 20% p.a. for the next three years;
- 3) The target is an IVD devices company;

We believe Yestar will insist on the above for future acquisitions. As such, acquisitions should help to accelerate earnings growth. Yestar has debt headroom of around Rmb350m for acquisitions assuming that its net debt to equity rises from the current 12% to 50%.

Maintain BUY with higher TP of HK\$4.3: In view of 20% EPS CAGR in 2016F-18F and potential acquisition to accelerate EPS growth, we maintain BUY. With the increase in our earnings estimates, we raise our TP from HK\$4.00 to HK\$4.3, pegged to the average FY16F PE of healthcare stocks in HK & Mainland China stock market (31x).

Interim Income Statement (RMBm)

	1H15	1H16	YoY	Remark
Revenue	999.5	1,436.8	44%	
In-vitro diagnostic products distribution	243.0	700.0	188%	The sales increase is due to hospitals coverage expansion from 270 in 1H15 to 588 in 1H16
Color photographic paper	268.0	221.0	-18%	Sales volume decline due to ASP increase
Medical imaging products	386.1	413.8	7%	
Industrial imaging products	102.5	102.0	-1%	
Gross Profit	179.5	356.2	98%	
Other Operating Income	1.4	16.1	1046%	The increase is mainly due to government grant
Distribution Costs	(37.7)	(54.0)	43%	
Administration Expenses	(39.0)	(95.7)	145%	
Others	(4.7)	(7.0)	49%	
EBIT	99.5	215.6	117%	
Interest Income	1.8	1.8	-4%	
Interest Expense	(6.1)	(19.6)	219%	The increase is mainly due to increase of total debt
Pretax Profit	95.2	197.8	108%	
Net Profit	55.6	106.3	91%	
Gross margin				
Overall	18.0%	24.8%		Thanks to increasing contribution from in-vitro diagnostic products segment.
In-vitro diagnostic products distribution	28.2%	36.7%		The margin expansion is due to increasing contribution from products with higher margin
Color photographic paper	15.7%	19.7%		The margin expansion is due to ASP increase
Medical imaging products	13.6%	10.5%		The margin contraction is due to ASP cut imposed by the largest client Fujifilm. Fujifilm is expanding market share through price cut, thus it imposed ASP cut on suppliers like Yestar.
Industrial imaging products	15.9%	12.5%		The margin contraction is due to ASP cut resulting from competition.
Cost % in revenue				
Distribution Costs	3.8%	3.8%		
Administration Expenses	3.9%	6.7%		The cost surge is due to Rmb36m of intangible assets amortisation
Others	0.5%	0.5%		
Effective tax rate	29.2%	28.8%		
EBIT margin	10.0%	15.0%		
Pretax profit margin	9.5%	13.8%		
Net margin	5.6%	7.4%		

Source: Company, DBS Vickers

CRITICAL DATA POINTS TO WATCH

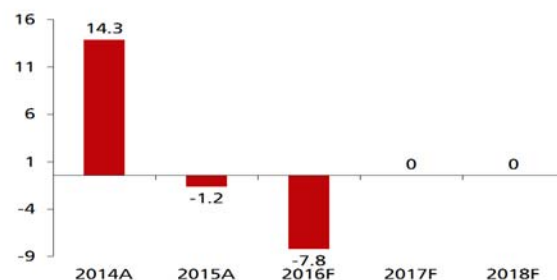
Earnings Drivers:

In-vitro diagnostic (IVD) devices. Starting from 2016, the IVD distribution business will make up over 50% of Yestar's projected earnings and become its top growth driver. We are confident on the IVD business as we see a favourable trend. In order to control subsidies on drug consumption, the Central government requires public hospitals to lower their drug sales % of total revenue from c.40% to 30% in 2017. Hence, hospitals will offer more IVD services to compensate for lowering drug sales, which will drive the demand for IVD devices.

Medical film. Yestar is producing medical films for Fujifilm. The growth of this segment is mainly driven by Fujifilm's market share gain. Its market share has already increased from 12.8% in 2012 to 18% in 1H14. It targets to reach 30% in 2016 and we believe this is achievable. The medical films are mainly used in Fujifilm's medical imaging devices. Demand growth for medical imaging devices has accelerated since the medical reform in 2009. The average lifespan of a medical imaging device is 3-5 years. In 2014-16, some medical imaging devices had reached their retirement age and Fujifilm grasped this opportunity to aggressively promote its medical imaging devices by launching new products at attractive prices. We believe it is able to continue with this strategy.

Color photographic paper. Yestar is producing and distributing color photographic paper for Fujifilm in China. The sales of this segment should remain stable.

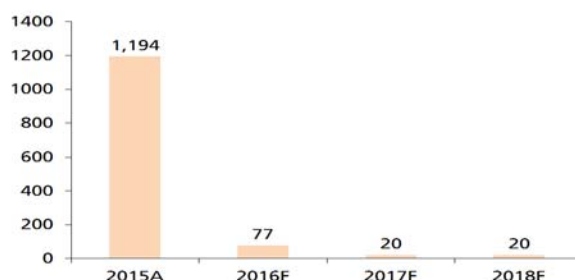
Color photographic paper - revenue growth %



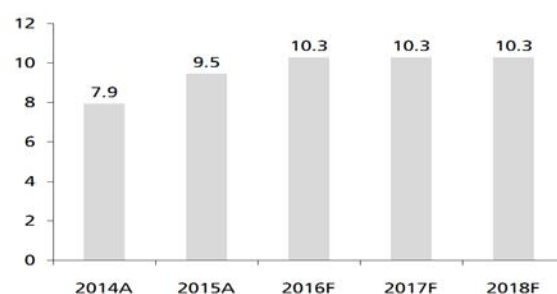
Medical imaging products - revenue growth %



In-vitro diagnostic products - revenue growth %



SG&A % in total sales



Source: Company, DBS Vickers

Balance Sheet:

Shareholders' equity. In Jun 2015, Yestar announced the issuance of 320m new shares at HK\$3ps to raise HK\$939m (c.Rmb751m) from 18 subscribers, including OrbiMed (assets under management: US\$15bn), Vivo Capital (assets under management: US\$1.7bn), World Healthcare Trust, and China Asset Management Co. The shareholder's equity of Yestar was strengthened after this exercise which allows it to have more financial resources to pursue new opportunities.

Share Price Drivers:

M&A. After acquiring two in-vitro diagnostic device distributors in 4Q 2014 and 3Q 2015, we believe Yestar will further expand its medical device business through M&A. Successful M&A could be a share price catalyst.

Key Risks:

Slowdown in demand for color photographic paper

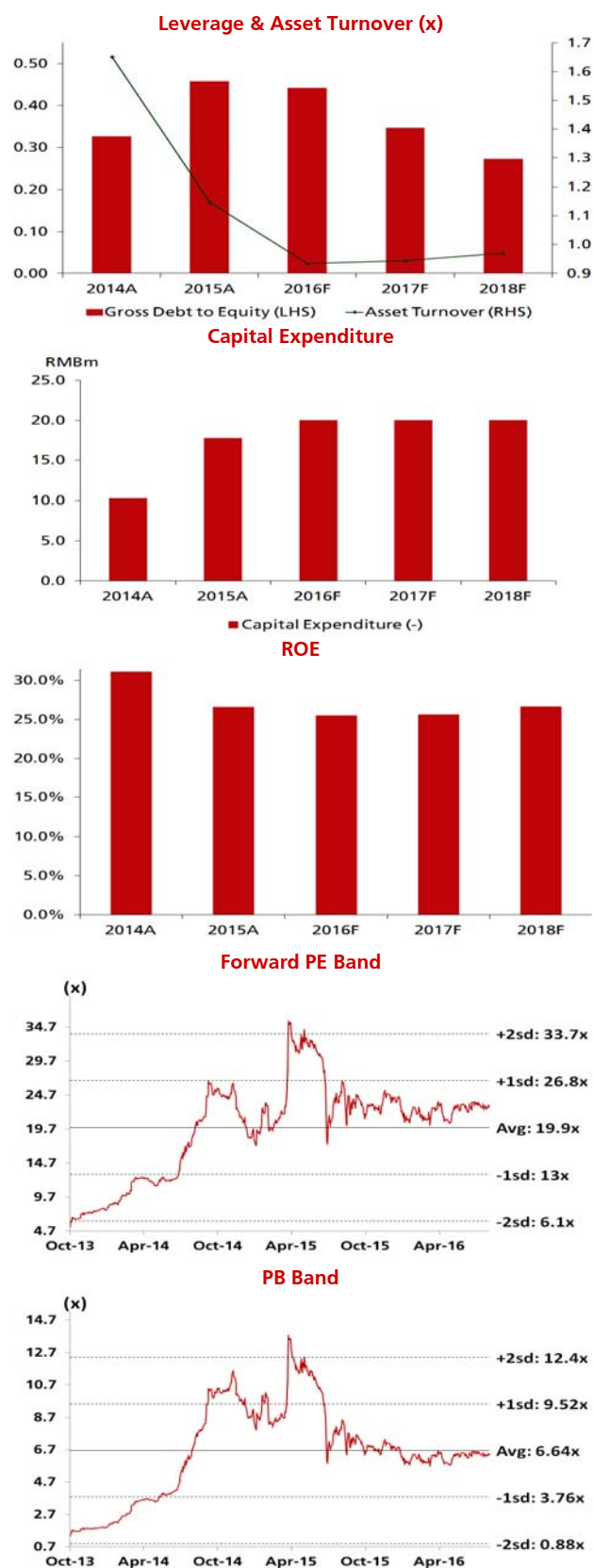
Declining sales growth of color photographic paper business due to increasing popularity of digitalization would hurt sales growth.

Price cut

Potential price cuts in medical film and color photographic paper to gain market share could create gross margin pressure.

Company Background:

Yestar is a medical film and colour photographic paper maker, mainly producing and distributing products for Fujifilm. It is also an in-vitro diagnostic (IVD) device distributor, mainly distributing the IVD devices of Roche (ROG VX) in China.



Source: Company, DBS Vickers

Key Assumptions

FY Dec	2014A	2015A	2016F	2017F	2018F
Color photographic paper - revenue growth %	14.3	(1.2)	(7.8)	0.0	0.0
Medical imaging products - revenue growth %	37.6	18.3	7.5	5.0	5.0
In-vitro diagnostic products - revenue growth %	N/A	1,194.3	77.0	20.0	20.0
SG&A % in total sales	7.9	9.5	10.3	10.3	10.3

Source: Company, DBS Vickers

Segmental Breakdown (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenues (RMB m)					
Color photographic paper	607	599	553	553	553
Medical imaging products	653	772	830	872	915
In-vitro diagnostic products distribution	69	887	1,570	1,884	2,260
Others	204	196	196	196	196
Total	1,531	2,455	3,149	3,504	3,925
Gross profit (RMB m)					
Color photographic paper	131	99	111	111	111
Medical imaging products	79	117	91	96	101
In-vitro diagnostic products distribution	17	270	578	703	855
Others	36	31	26	26	26
Total	263	517	805	935	1,091
Gross margin (%)					
Color photographic paper	21.6	16.6	20.0	20.0	20.0
Medical imaging products	12.1	15.1	11.0	11.0	11.0
In-vitro diagnostic products distribution	25.0	30.5	36.8	37.3	37.8
Others	17.9	15.9	13.0	13.0	13.0
Total	17.2	21.1	25.6	26.7	27.8

Source: Company, DBS Vickers

Income Statement (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenue	1,531	2,455	3,149	3,504	3,925
Cost of Goods Sold	(1,268)	(1,937)	(2,344)	(2,570)	(2,833)
Gross Profit	263	517	805	935	1,091
Other Opng (Exp)/Inc	(115)	(215)	(308)	(357)	(401)
Operating Profit	148	302	497	577	691
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(1)	(23)	(33)	(25)	(22)
Dividend Income	0	0	0	0	1
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	147	280	464	553	669
Tax	(44)	(81)	(135)	(160)	(194)
Minority Interest	(3)	(36)	(75)	(91)	(109)
Preference Dividend	0	0	0	0	0
Net Profit	101	163	254	302	366
Net Profit before Except.	101	163	254	302	367
EBITDA	166	360	582	661	776
Growth					
Revenue Gth (%)	30.5	60.3	28.3	11.3	12.0
EBITDA Gth (%)	49.0	116.8	61.3	13.7	17.3
Opg Profit Gth (%)	51.2	103.8	64.4	16.1	19.6
Net Profit Gth (%)	55.1	61.3	56.4	18.6	21.2
Margins & Ratio					
Gross Margins (%)	17.2	21.1	25.6	26.7	27.8
Opg Profit Margin (%)	9.7	12.3	15.8	16.5	17.6
Net Profit Margin (%)	6.6	6.6	8.1	8.6	9.3
ROAE (%)	31.1	26.6	25.5	25.6	26.6
ROA (%)	10.9	7.6	7.6	8.1	9.0
ROCE (%)	18.3	14.6	14.4	14.9	16.2
Div Payout Ratio (%)	50.0	43.7	50.0	50.0	50.0
Net Interest Cover (x)	106.8	13.4	15.2	23.4	30.9

Source: Company, DBS Vickers

Interim Income Statement (RMB m)

FY Dec	1H2014	2H2014	1H2015	2H2015	1H2016
Revenue	694	837	1,000	1,455	1,437
Cost of Goods Sold	(585)	(687)	(820)	(1,117)	(1,081)
Gross Profit	109	151	180	338	356
Other Oper. (Exp)/Inc	(55)	(60)	(80)	(135)	(141)
Operating Profit	54	91	100	203	216
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	0	(1)	(4)	(18)	(18)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	53	90	95	185	198
Tax	(16)	(27)	(28)	(54)	(57)
Minority Interest	0	(3)	(12)	(24)	(35)
Net Profit	37	60	56	107	106
Net profit bef Except.	37	60	56	107	106
Growth					
Revenue Gth (%)	34.7	27.2	44.0	73.8	43.7
Opg Profit Gth (%)	22.2	68.4	85.3	122.2	116.7
Net Profit Gth (%)	30.9	64.5	49.0	78.1	91.2
Margins					
Gross Margins (%)	15.7	18.0	18.0	23.2	24.8
Opg Profit Margins (%)	7.7	10.9	10.0	13.9	15.0
Net Profit Margins (%)	5.4	7.2	5.6	7.4	7.4

Source: Company, DBS Vickers

Balance Sheet (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Net Fixed Assets	104	117	117	116	116
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	360	1,531	1,467	1,403	1,339
Cash & ST Invts	199	506	817	1,090	1,379
Inventory	327	415	441	491	549
Debtors	105	553	693	701	824
Other Current Assets	23	42	42	42	42
Total Assets	1,118	3,164	3,576	3,843	4,248
ST Debt	102	248	260	250	240
Creditors	283	450	504	526	628
Other Current Liab	167	444	444	444	444
LT Debt	5	173	260	250	240
Other LT Liabilities	237	932	932	932	932
Shareholder's Equity	316	907	1,091	1,265	1,480
Minority Interests	9	10	85	176	284
Total Cap. & Liab.	1,118	3,164	3,576	3,843	4,248
Non-Cash Wkg. Capital	5	115	227	263	343
Net Cash/(Debt)	93	86	297	590	899
Debtors Turn (avg days)	14.5	48.9	72.2	72.6	70.9
Creditors Turn (avg days)	72.7	71.2	77.0	75.6	76.6
Inventory Turn (avg days)	87.6	72.1	69.1	68.4	69.0
Asset Turnover (x)	1.7	1.1	0.9	0.9	1.0
Current Ratio (x)	1.2	1.3	1.6	1.9	2.1
Quick Ratio (x)	0.6	0.9	1.2	1.5	1.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	9.7	4.2	3.8	4.0	4.2
Z-Score (X)	NA	NA	NA	NA	NA

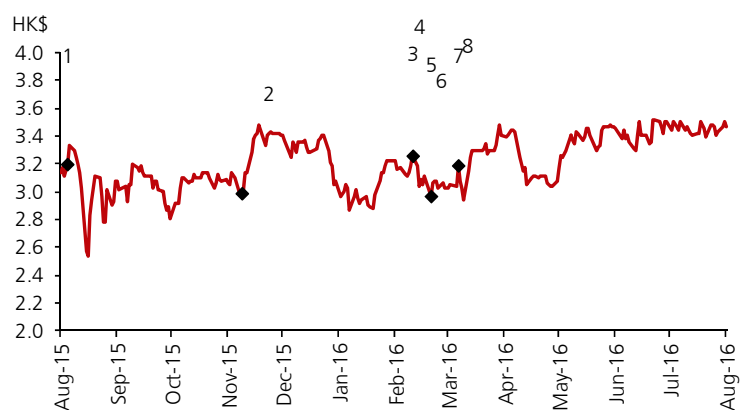
Source: Company, DBS Vickers

Cash Flow Statement (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Pre-Tax Profit	147	280	464	553	668
Dep. & Amort.	18	58	84	84	85
Tax Paid	(29)	(60)	(135)	(160)	(194)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(26)	(139)	(112)	(36)	(80)
Other Operating CF	3	26	33	25	22
Net Operating CF	113	165	335	465	502
Capital Exp.(net)	(10)	(18)	(20)	(20)	(20)
Other Invts.(net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(138)	(789)	5	7	8
Net Investing CF	(149)	(807)	(15)	(13)	(12)
Div Paid	(36)	(50)	(71)	(127)	(151)
Chg in Gross Debt	(11)	314	100	(20)	(20)
Capital Issues	0	729	0	0	0
Other Financing CF	(6)	(40)	(38)	(31)	(30)
Net Financing CF	(53)	952	(9)	(178)	(201)
Currency Adjustments	0	1	0	0	0
Chg in Cash	(88)	311	310	273	289
Opg CFPS (RMB)	0.07	0.15	0.20	0.23	0.27
Free CFPS (RMB)	0.06	0.07	0.14	0.20	0.22

Source: Company, DBS Vickers

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	13-Aug-15	HK\$3.11	HK\$4.27	Buy
2:	17-Nov-15	HK\$2.98	HK\$4.27	Buy
3:	19-Feb-16	HK\$3.26	HK\$4.00	Buy
4:	19-Feb-16	HK\$3.26	HK\$4.00	Buy
5:	29-Feb-16	HK\$2.97	HK\$4.00	Buy
6:	29-Feb-16	HK\$2.97	HK\$4.00	Buy
7:	15-Mar-16	HK\$3.04	HK\$4.00	Buy
8:	15-Mar-16	HK\$3.04	HK\$4.00	Buy

Source: DBS Vickers

Analyst: Mark Kong CFA

DBSV 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 catalysts within this time frame)

Share price appreciation + dividends

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