

# China / Hong Kong Company Guide

# Yestar International

Version 6 | Bloomberg: 2393 HK Equity | Reuters: 2393.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

14 Nov 2016

## BUY

Last Traded Price ( 11 Nov 2016):HK\$4.01 (HSI : 22,531)  
 Price Target 12-mth: HK\$4.70 (17% upside) (Prev HK\$4.30)

Potential Catalyst: M&A of In-vitro diagnostic devices distributors

### Analyst

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### What's New

- Trimmed 16F-18F earnings by 3-12% for bond interest cost and amortization of intangible assets after acquisition of three diagnostic devices distributors
- Diagnostic devices sales network expanded from Eastern to Southern China after the acquisition, strengthening growth potential in long run.
- TP raised to HK\$4.70 as we shift our valuation base to FY17F and impute a higher target PE of 34x (from 31x 16F PE) due to stronger growth potential in the long run.

### Price Relative



### Forecasts and Valuation

FY Dec (RMB m)	2015A	2016F	2017F	2018F
Turnover	2,455	3,149	4,323	4,989
EBITDA	360	578	787	954
Pre-tax Profit	280	449	555	723
Net Profit	163	243	267	356
Net Pft (Pre Ex)	163	243	267	357
Net Profit Gth (Pre-ex) (%)	61.3	49.4	9.7	33.5
EPS (RMB)	0.08	0.11	0.12	0.16
EPS (HK\$)	0.09	0.13	0.14	0.19
Core EPS (HK\$)	0.09	0.13	0.14	0.19
Core EPS (RMB)	0.08	0.11	0.12	0.16
EPS Gth (%)	48.6	38.5	9.7	33.5
Core EPS Gth (%)	48.6	38.5	9.7	33.9
Diluted EPS (HK\$)	0.09	0.13	0.14	0.19
DPS (HK\$)	0.04	0.06	0.07	0.09
BV Per Share (HK\$)	0.47	0.56	0.64	0.75
PE (X)	43.8	31.7	28.8	21.6
Core PE (X)	43.8	31.7	28.8	21.6
P/Cash Flow (X)	43.2	22.9	17.7	12.5
P/Free CF (X)	48.4	24.4	18.6	12.9
EV/EBITDA (X)	19.6	13.9	10.6	8.6
Net Div Yield (%)	0.9	1.6	1.7	2.3
P/Book Value (X)	8.5	7.1	6.3	5.3
Net Debt/Equity (X)	CASH	0.2	0.3	0.1
ROAE (%)	26.6	24.5	23.2	26.7
Earnings Rev (%)		(5)	(12)	(3)
Consensus EPS (RMB)		0.13	0.16	0.20
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 Eastern & Southern China. 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\$4.70 is pegged to 34x FY17F PE, representing 10% premium over healthcare sector's average in HK and Mainland China of 31x 17F PE.

### 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\$/US\$m)	8,723 / 1,124
Major Shareholders	
Hartono family (%)	71.1
Free Float (%)	28.9
3m Avg. Daily Val. (US\$m)	1.7

ICB Industry : Industrials / Support Services

**WHAT'S NEW****Expanding sales network to capture strong demand in Southern China**

**Acquisition to expand diagnostic devices sales network to Southern China:** In Oct & Nov 2016, Yestar announced the acquisition of 70% stakes in three distributors of Roche IVD devices in Guangdong province. The consideration was Rmb336m, Rmb428m and Rmb167m respectively, implying FY17F PE of 10x, 12x, 10x based on the guaranteed profit offered by the sellers. The total guaranteed profit of the three distributors attributable to Yestar is Rmb86m, Rmb112m, and Rmb147m in FY17-19F respectively, implying earnings CAGR of 31% during the period. If the guaranteed profits are achieved, Yestar will distribute 30% earnings of the acquired companies to the sellers as dividend. Also, their remaining stakes can be sold to Yestar after 2019 based on 10-12x 19A PE or at a maximum of Rmb722m in total. Otherwise, they would have to compensate Yestar for the shortfall between guaranteed profit and actual profit. After the deals, Yestar's IVD devices distribution business will expand from only Eastern China (Shanghai, Anhui & Jiangsu provinces) to Southern China (Guangdong province, Fujian province, Hainan province).

**Trimmed FY16F-18F earnings due to intangible assets amortization arising from the acquisition and bond interest cost:** We have lowered our earnings estimates in FY16F/17F/18F by 5%/12%/3% to reflect:

- 1) The guaranteed profit offered by the three IVD devices distributors in Southern China;
- 2) The increase in amortization expense on intangible assets after the deals. We estimate the increase will be Rmb37m p.a. for the next 15 years;
- 3) The increase in net interest by Rmb13m /Rmb 85m / Rmb85m in FY16F / 17F / 18F due to issuance of bond in Sep 2016. To finance the acquisition mentioned above, Yestar issued corporate bond in Sep to raise US\$200m at an interest cost of 6.9%.

**Raise TP to HK\$4.7 on stronger long term growth from sales network expansion.** Even though we have revised down our earnings estimates, the expected EBITDA CAGR in 2015-18 is much stronger than before our revision (38% vs 29%). The IVD device business is the major growth driver for Yestar, which makes up over 50% of its earnings currently. Its sales network has now expanded from only Eastern China to Southern China, laying a stronger foundation for long term growth. Our previous TP was based on 31x FY16F PE, pegged to the average PE valuation of healthcare sector in HK & Mainland China. Due to stronger long term growth prospects, we apply a 10% premium over sector average to derive a target PE of 34x. Rolling over our valuation base to FY17F, we raise our TP to HK\$4.7 based on 34x FY17F PE. Maintain BUY.

**CRITICAL DATA POINTS TO WATCH**

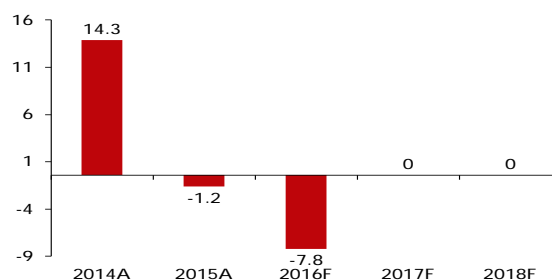
**Earnings Drivers:**

**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 favorable 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.

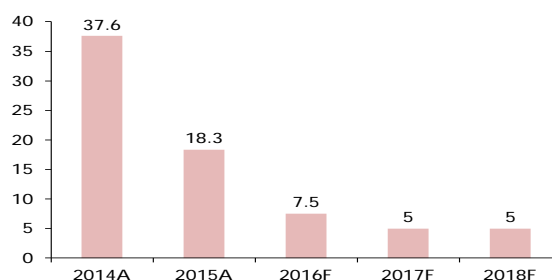
**Medical film.** Yestar is producing medical films for Fujifilm. The growth of this segment is mainly driven by Fujifilm's market share gain. Its market share has already increased from 12.8% in 2012 to 18% in 1H14. It targets to reach 30% in 2016 and we believe this is achievable. The medical films 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.

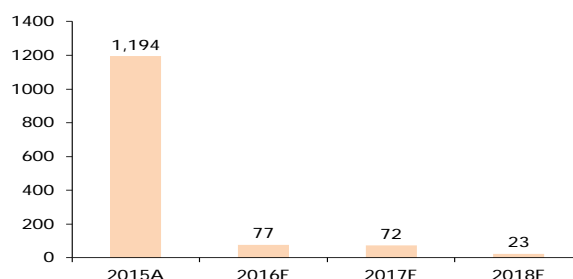
**Color photographic paper - revenue growth %**



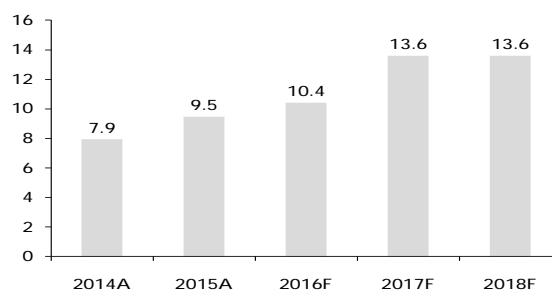
**Medical imaging products - revenue growth %**



**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 four in-vitro diagnostic device distributors in 4Q 2014 and 3Q 2015 and 2H2016, we believe Yestar will further expand its medical device business through M&A. Successful M&A could be a share price catalyst.

**Key Risks:**

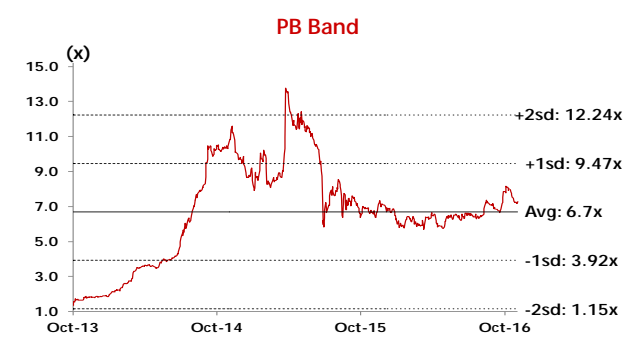
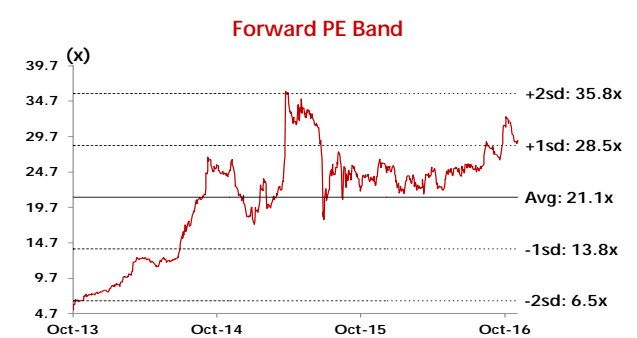
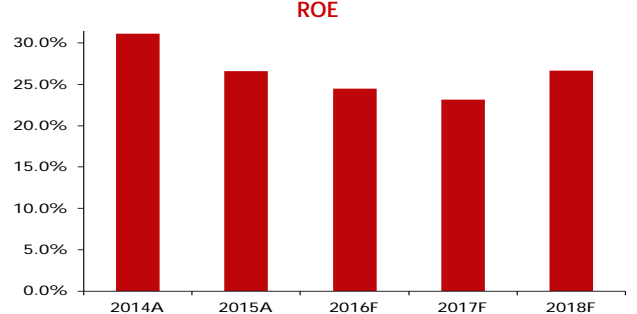
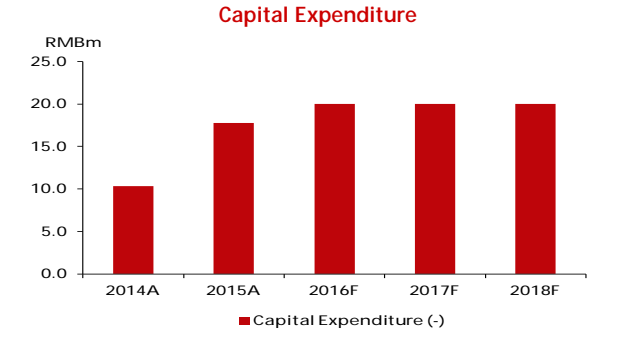
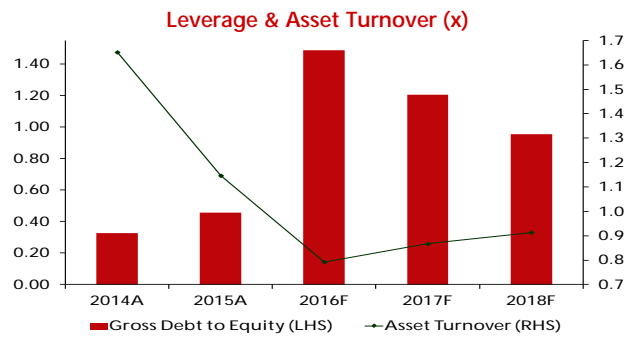
**Slowdown in demand for color photographic paper**  
Declining sales growth of color photographic paper business due to increasing popularity of digitalization would hurt sales growth.

**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	72.2	23.0
SG&A % in total sales	7.9	9.5	10.4	13.6	13.6

*Source: Company, DBS Vickers*

**Segmental Breakdown (RMB m)**

FY Dec	2014A	2015A	2016F	2017F	2018F
<b>Revenues (RMB m)</b>					
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	2,702	3,325
Others	204	196	196	196	196
<b>Total</b>	<b>1,531</b>	<b>2,455</b>	<b>3,149</b>	<b>4,323</b>	<b>4,989</b>
<b>Gross margin (RMB m)</b>					
Color photographic paper	131	99	111	111	111
Medical imaging products	79	117	91	96	101
In-vitro diagnostic products distribution	17	270	578	1,018	1,270
Others	36	31	26	26	26
<b>Total</b>	<b>263</b>	<b>517</b>	<b>805</b>	<b>1,250</b>	<b>1,506</b>
<b>Gross margin Margins (%)</b>					
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	37.7	38.2
Others	17.9	15.9	13.0	13.0	13.0
<b>Total</b>	<b>17.2</b>	<b>21.1</b>	<b>25.6</b>	<b>28.9</b>	<b>30.2</b>

*Source: Company, DBS Vickers*

## Income Statement (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenue	1,531	2,455	3,149	4,323	4,989
Cost of Goods Sold	(1,268)	(1,937)	(2,344)	(3,073)	(3,483)
<b>Gross Profit</b>	<b>263</b>	<b>517</b>	<b>805</b>	<b>1,250</b>	<b>1,506</b>
Other Opng (Exp)/Inc	(115)	(215)	(311)	(584)	(675)
<b>Operating Profit</b>	<b>148</b>	<b>302</b>	<b>494</b>	<b>665</b>	<b>831</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(1)	(23)	(45)	(110)	(109)
Dividend Income	0	0	0	0	1
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>147</b>	<b>280</b>	<b>449</b>	<b>555</b>	<b>723</b>
Tax	(44)	(81)	(130)	(161)	(209)
Minority Interest	(3)	(36)	(75)	(127)	(157)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>101</b>	<b>163</b>	<b>243</b>	<b>267</b>	<b>356</b>
Net Profit before Except.	101	163	243	267	357
EBITDA	166	360	578	787	954
<b>Growth</b>					
Revenue Gth (%)	30.5	60.3	28.3	37.3	15.4
EBITDA Gth (%)	49.0	116.8	60.5	36.0	21.2
Opg Profit Gth (%)	51.2	103.8	63.4	34.7	24.9
Net Profit Gth (%)	55.1	61.3	49.4	9.7	33.5
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	17.2	21.1	25.6	28.9	30.2
Opg Profit Margin (%)	9.7	12.3	15.7	15.4	16.7
Net Profit Margin (%)	6.6	6.6	7.7	6.2	7.1
ROAE (%)	31.1	26.6	24.5	23.2	26.7
ROA (%)	10.9	7.6	6.1	5.4	6.5
ROCE (%)	18.3	14.6	11.5	11.9	13.8
Div Payout Ratio (%)	50.0	43.7	50.0	50.0	50.0
Net Interest Cover (x)	106.8	13.4	10.9	6.0	7.6

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)
<b>Gross Profit</b>	<b>109</b>	<b>151</b>	<b>180</b>	<b>338</b>	<b>356</b>
Other Oper. (Exp)/Inc	(55)	(60)	(80)	(135)	(141)
<b>Operating Profit</b>	<b>54</b>	<b>91</b>	<b>100</b>	<b>203</b>	<b>216</b>
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
<b>Pre-tax Profit</b>	<b>53</b>	<b>90</b>	<b>95</b>	<b>185</b>	<b>198</b>
Tax	(16)	(27)	(28)	(54)	(57)
Minority Interest	0	(3)	(12)	(24)	(35)
<b>Net Profit</b>	<b>37</b>	<b>60</b>	<b>56</b>	<b>107</b>	<b>106</b>
Net profit bef Except.	37	60	56	107	106
<b>Growth</b>					
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
<b>Margins</b>					
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	2,026	2,297	2,196
Cash & ST Invts	199	506	1,461	1,271	1,626
Inventory	327	415	441	605	698
Debtors	105	553	693	865	1,048
Other Current Assets	23	42	42	42	42
<b>Total Assets</b>	<b>1,118</b>	<b>3,164</b>	<b>4,779</b>	<b>5,196</b>	<b>5,725</b>
ST Debt	102	248	260	260	260
Creditors	283	450	504	648	798
Other Current Liab	167	444	444	444	444
LT Debt	5	173	1,474	1,474	1,474
Other LT Liabilities	237	932	932	932	932
Shareholder's Equity	316	907	1,080	1,225	1,448
Minority Interests	9	10	85	213	369
<b>Total Cap. &amp; Liab.</b>	<b>1,118</b>	<b>3,164</b>	<b>4,779</b>	<b>5,196</b>	<b>5,725</b>
Non-Cash Wkg. Capital	5	115	227	419	545
Net Cash/(Debt)	93	86	(273)	(463)	(108)
Debtors Turn (avg days)	14.5	48.9	72.2	65.7	70.0
Creditors Turn (avg days)	72.7	71.2	77.0	71.2	78.5
Inventory Turn (avg days)	87.6	72.1	69.1	64.7	70.8
Asset Turnover (x)	1.7	1.1	0.8	0.9	0.9
Current Ratio (x)	1.2	1.3	2.2	2.1	2.3
Quick Ratio (x)	0.6	0.9	1.8	1.6	1.8
Net Debt/Equity (X)	CASH	CASH	0.2	0.3	0.1
Net Debt/Equity ex MI (X)	CASH	CASH	0.3	0.4	0.1
Capex to Debt (%)	9.7	4.2	1.2	1.2	1.2
Z-Score (X)	NA	NA	NA	NA	NA

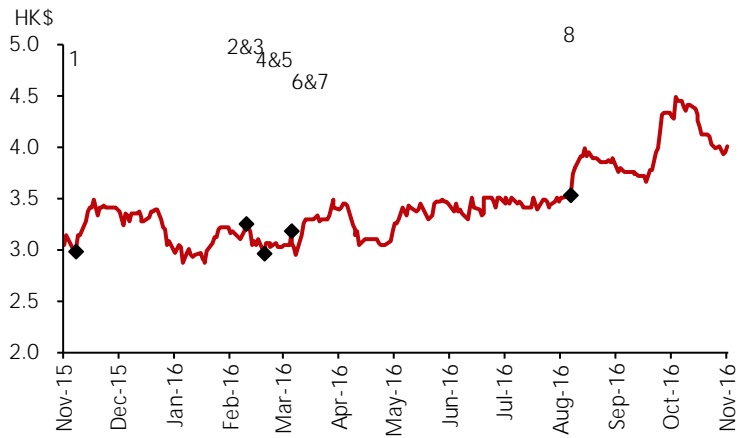
Source: Company, DBS Vickers

### Cash Flow Statement (RMB m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Pre-Tax Profit	147	280	449	555	722
Dep. & Amort.	18	58	84	121	122
Tax Paid	(29)	(60)	(130)	(161)	(209)
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)	(192)	(127)
Other Operating CF	3	26	45	110	109
<b>Net Operating CF</b>	<b>113</b>	<b>165</b>	<b>336</b>	<b>434</b>	<b>617</b>
Capital Exp.(net)	(10)	(18)	(20)	(20)	(20)
Other Invts.(net)	0	0	(559)	(372)	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(138)	(789)	7	13	13
<b>Net Investing CF</b>	<b>(149)</b>	<b>(807)</b>	<b>(572)</b>	<b>(379)</b>	<b>(7)</b>
Div Paid	(36)	(50)	(71)	(122)	(133)
Chg in Gross Debt	(11)	314	1,314	0	0
Capital Issues	0	729	0	0	0
Other Financing CF	(6)	(40)	(53)	(123)	(122)
<b>Net Financing CF</b>	<b>(53)</b>	<b>952</b>	<b>1,190</b>	<b>(245)</b>	<b>(256)</b>
Currency Adjustments	0	1	0	0	0
Chg in Cash	(88)	311	954	(190)	355
Opg CFPS (RMB)	0.07	0.15	0.20	0.29	0.34
Free CFPS (RMB)	0.06	0.07	0.14	0.19	0.27

Source: Company, DBS Vickers

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	17-Nov-15	HK\$2.98	HK\$4.27	Buy
2:	19-Feb-16	HK\$3.26	HK\$4.00	Buy
3:	19-Feb-16	HK\$3.26	HK\$4.00	Buy
4:	29-Feb-16	HK\$2.97	HK\$4.00	Buy
5:	29-Feb-16	HK\$2.97	HK\$4.00	Buy
6:	15-Mar-16	HK\$3.04	HK\$4.00	Buy
7:	15-Mar-16	HK\$3.04	HK\$4.00	Buy
8:	16-Aug-16	HK\$3.53	HK\$4.30	Buy

Source: DBS Vickers

Analyst: Mark Kong CFA

DBSVHK 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*

Completed Date: 14 Nov 2016 12:22:41

Dissemination Date: 14 Nov 2016 14:15:37

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