MOODY'S INVESTORS SERVICE

CREDIT OPINION
22 March 2017

Update

Rate this Research

RATINGS

Yestar Healthcare Holdings Company Limited

Domicile	China
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Yestar Healthcare Holdings Company Limited

Update following 2016 full-year results

Summary Rating Rationale

Yestar Healthcare Holdings Company Limited's Ba3 corporate family rating reflects the company's (1) solid position in the distribution of medical consumable products in China; (2) strong and sustainable partnership with leading global players; and (3) risk-controlled M&A strategy and prudent financial management.

At the same time, Yestar's rating is constrained by the company's (1) modest size and high supplier concentration; (2) relatively short operating history in distributing in vitro diagnostic (IVD) products; and (3) high cash investment requirements as it continues to pursue growth.

Credit Strengths

» Beneficiary of growth in medical consumable products in China

» Stable film business buttressed by long relationship with Fujifilm Holdings Corporation (A1 stable) and film processing capabilities

» Customer stickiness in IVD offsets risk from a lack of long-term supplier contracts

Credit Challenges

» Small scale with high supplier concentration

» M&A risks mitigated by prudent deal structures and financial management

» Solid operating cash flows, but major acquisitions will require additional funding

» Evolving regulatory landscape

Rating Outlook

The stable outlook reflects Moody's expectation that Yestar will maintain (1) its stable relationships with its key suppliers and customers; (2) a steady film business, while its IVD consumable business continues to grow; (3) a prudent M&A strategy and financial management, including pre-funding of M&A and no change to existing dividend policy; and (4) strong corporate governance.

Factors that Could Lead to an Upgrade

Given the short history of Yestar's IVD business and the company's small scale, an upgrade is unlikely in the near term. Nevertheless, upward rating pressure could emerge if Yestar continues to build a strong M&A and execution track record, grows its scale, and diversifies its key supplier relationships. Credit metrics indicative of upward rating pressure include adjusted debt/EBITDA below or around 2.0x, and retained cash flow (RCF)/debt above 20% on a sustained basis.

Factors that Could Lead to a Downgrade

Downward rating pressure could emerge if Yestar's operating performance and/or financial profile deteriorate due to (1) a weakening in key supplier relationships; (2) a decline in its competitiveness, or significant change in the competitive landscape for the film or IVD market; (3) the pursuit of a more aggressive financial management policy, or failure to maintain sound corporate governance. Credit metrics indicative of downward rating pressure include adjusted debt/EBITDA above 3.0x-3.5x or RCF/debt below 12%.

Key Indicators

Exhibit 1

Yestar Healthcare Holdings Company Limited [1][2]

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Revenue (USD Billion)	$0.2	$0.2	$0.2	$0.4	$0.5
EBITA (USD Billion)	$0.0	$0.0	$0.0	$0.1	$0.1
Reported Operating Margin	8.0%	8.0%	9.7%	11.9%	14.0%
Debt / EBITDA	0.7x	1.2x	0.7x	1.3x	3.2x
EBITA / Interest	21.0x	14.8x	22.1x	15.5x	8.1x
RCF / Debt	110.6%	-5.9%	81.2%	52.4%	19.0%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] Ratios for 2016 data are estimated based on the company's earnings release and subject to adjustment when full financial statements are released.
Source: Moody's Financial Metrics™

Detailed Rating Considerations

1. BENEFICIARY TO GROWTH IN MEDICAL CONSUMABLE PRODUCTS IN CHINA

Yestar is well positioned in the medical consumable segment in China, amid an aging population and rising healthcare spending and investment. It distributes IVD products by global diagnostics leader Roche, as well as by Thermo Fisher Scientific Inc. (Baa2 stable) and Becton, Dickinson and Company (Baa2 stable). Moreover, it is the largest manufacturer and distributor of Fujfilm medical and dental film in China (Aa3 negative), producing both under the Fujifilm brand and its own Yes!Star brand for dental film.

We project the company's medical consumable sales to grow more than 20% CAGR to around RMB4.4 billion in 2019 from 2016. IVD products also have higher gross margins at around 28% compared with the 12%-18% among its other main product segments.

2. STABLE FILM BUSINESS BUTTRESSED BY LONG RELATIONSHIP WITH FUJIFILM AND FILM PROCESSING CAPABILITY

Yestar's mature film business will continue to generate steady revenue and cash flow, helped by the company's long-standing relationship with Fujifilm, which holds strong market positions, and Yestar's manufacturing capabilities. The company began purchasing color photographic paper and color film from Fujifilm in 2001, and it has been the exclusive distributor of Fujifilm color photographic paper in China since 2013.

In addition, Yestar is the only processor Fujifilm has engaged in China for processing Fujifilm medical film and printed wiring board (PWB) film sold on the mainland.

Yestar also makes industrial non-destructive testing (NDT) x-ray film, used for checking the structural integrity of machinery, as well as dental film, under its own Yes!Star brand. All of the company's manufacturing and processing are done at its three factories in Nanning in Guangxi province.

3. CUSTOMER STICKINESS IN IVD OFFSETS RISK FROM A LACK OF LONG-TERM SUPPLIER CONTRACTS

Yestar does not have long-term supplier contracts with Roche or the other IVD suppliers. However, the business risk is mitigated by its access to – and long-term contracts with – end-customers. The company has also built a solid track record in its management of its relationship with Fujifilm, another company that does not usually offer long-term contracts or grant exclusivities.

IVD manufacturers' distribution agreements are generally non-exclusive and need to be renewed annually. On the other hand, Yestar's contracts with hospitals and clinics can last from one to eight years, and its contracts with local distributors from one to four years. Such long-term contracts provide stability and give suppliers an incentive to maintain the relationship with their distributor. Distributors also provide value-added services such as equipment installation, testing, maintenance, technical support, warehousing, customer service, and receivable responsibilities.

In addition, once a hospital has signed to use a particular manufacturer's products, switching costs are high because it would have to change equipment and installations, and doctors also need to adjust to new data interpretation and analysis. As a result, there is high customer stickiness.

4. SMALL SCALE WITH HIGH SUPPLIER CONCENTRATION

Yestar is a small company (2016 revenue of RMB3 billion) relative to its rated global healthcare peers. It is also heavily dependent on two supplier relationships – with Fujifilm and Roche. In addition, although it has national distribution rights for Fujifilm products, its IVD footprint has yet to be further expanded from eastern and southern China.

Around half of Yestar's revenue in 2016 was related to Fujifilm, including color photographic film, industrial film, and medical and dental film. However, this exposure was mitigated by the company being the sole manufacturer for Fujifilm in China in several product categories. The relationship also has a long history dating back to 1971, when the family of Yestar's founder Mr. Hartono first started distributing Fujifilm products in Indonesia.

Yestar derived the other half of 2016 revenue from its growing IVD business, with Roche accounting for the vast majority of segment sales. The relationship only started in 2014, but Yestar has, through acquisitions and organic growth, already become one of Roche's largest IVD product distributors in China.

5. M&A RISKS MITIGATED BY PRUDENT DEAL STRUCTURES AND FINANCIAL MANAGEMENT

The company entered the IVD distribution business through acquisitions. Since 2014, it has completed five acquisitions: Jiangsu Uno in 2014, Shanghai Emphasis in 2015, and Guangzhou Hongen, Guangzhou Shengshiyuan, and Shenzhen De Run Li Jia in 2017. It will make further acquisitions to supplement organic business growth. Such a business strategy can be risky, but the company mitigates such risk by carefully structuring deals and maintaining prudent financial management.

In all of its IVD acquisitions, Yestar buys a 70% stake upfront and acquires the remaining 30% of the companies after three-year profit guarantees have been achieved. Such a structure ensures that the acquired companies retain their value, and also gives Yestar time to adjust to running the new companies. The shareholders of the acquired companies are also required to enter non-compete agreements to prevent future competition.

6. SOLID OPERATING CASH FLOWS, BUT MAJOR ACQUISITIONS WILL REQUIRE ADDITIONAL FUNDING

Yestar generates solid cash flows from its operations, but working capital needs, dividends and acquisition payments will keep its free cash flow in the negative for the next two years. The company pre-funded for these needs with its $200 million bond issuance in 2016. However, if it pursues a sizable acquisition, it will need additional funding.

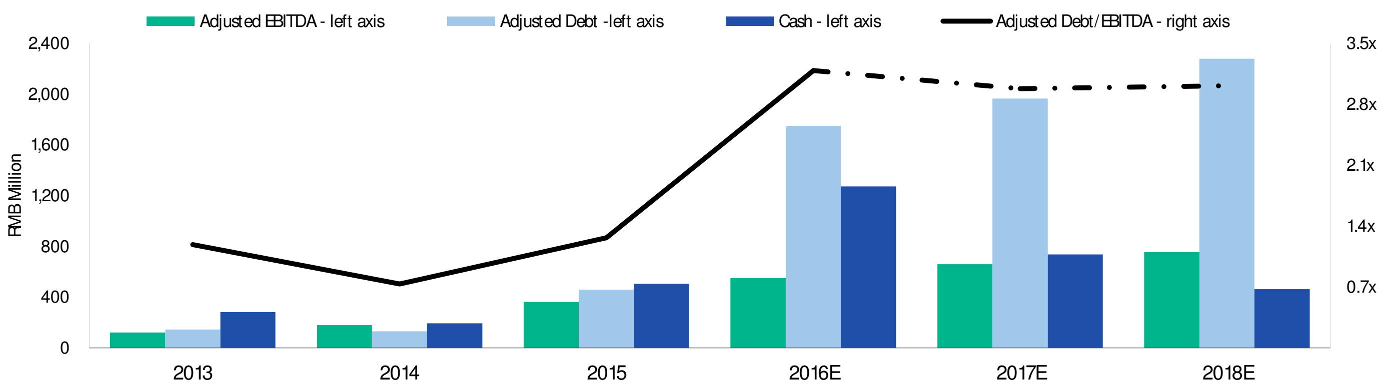
For its film business, Yestar generally receives 60 days credit from Fujifilm and cash from its customers. However for IVD, hospital payments can take as long as 240 days. As a result, as its IVD business grows, Yestar's working capital will be a drag on operating cash flows. At the same time, while the company has low capex requirements, its main investment cash outflow will be acquisitions, including payments to buyout the remaining 30% of acquired companies. Finally, the company plans to maintain 30%-50% dividend payouts.

As a result of these three factors, although we expect that Yestar's funds from operations will increase, free cash flow after acquisitions will remain negative in the next couple of years. The pre-funding of these negative free cash flows via a bond issuance drove the company's increase in total debt in 2016 to RMB1.7 billion from RMB420 million in 2015 (Exhibit 2).

Yestar's adjusted debt/EBITDA rose to around 3.2x in 2016 from 1.3x in 2015. We expect leverage to remain steady in 2017 as further modest acquisitions could be funded by cash on hand, and revenue and adjusted EBITDA grow around 20%. However, if the company pursues a significant transaction, additional funding will be required.

Exhibit 2

Yestar's debt pre-funding for its investments needs



Sources: Company's information and Moody's Investors Service estimates

7. EVOLVING REGULATORY LANDSCAPE

Healthcare is a heavily regulated market in China, especially since most hospitals are run by the government, which on the one hand reduces bad debt risk, but on the other hand also raises reimbursement and other regulatory risks. Currently, there are no price controls on IVD products and new products can also be introduced relatively easily by registration rather than by approval. However, this situation may change in the future with the increasing usage and costs of IVD.

Moreover, the high-end IVD segment in which Yestar operates is currently dominated by foreign suppliers, including Roche, Siemens Aktiengesellschaft (A1 stable), Abbott Laboratories (Baa3, stable), Beckman Coulter, Inc. (unrated), and margins are healthy. Local competitors do not yet pose significant competition, given their technological limitations. However, if the government decides to groom national champions like it has been doing in other industries (e.g., telecom equipment, semiconductors and chemicals), the competitive landscape may change.

Liquidity Analysis

Yestar's liquidity is solid. Its cash balance of RMB1.3 billion at end-2016, compared with RMB506 million at end-2015, will be sufficient to cover its RMB225 million in short-term debt, even after committing around RMB700 million to close its recent acquisitions.

Structural Considerations

We do not notch the senior unsecured bond because the ratio of secured debt and debt issued by operating subsidies over total assets was 5% at end-2016. We expect this ratio will remain low compared with our threshold ratio of 15%.

Corporate Profile

Yestar Healthcare Holdings Company Limited was established in 2000 and is headquartered in Shanghai. It has been listed on the Hong Kong Stock Exchange since 2013. It is one of the largest distributors of Roche Holding AG's diagnostics products in China and the largest distributor of Fujifilm Holdings Corporation's film products in the mainland since 2014. Yestar is 63%-owned by its founder, chairman and CEO, James Hartono and his siblings.

Rating Methodology and Scorecard Factors

The principal methodology used in these ratings was Distribution and Supply Chain Services, published in December 2015. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Exhibit 3

Rating Factors

Distribution and Supply Chain Services Industry Grid [1][2]	Current FY 12/31/2016								Moody's 12-18 Month Forward View As of 3/20/2017 [3]							
Factor 1 : Scale (20%)	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**	**Ca**	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**	**Ca**
a) Revenue (USD Billion)								X							X	
b) EBITA (USD Billion)						X								X		
Factor 2 : Business Profile (15%)																
a) Business Profile						X								X		
Factor 3 : Profitability & Efficiency (15%)																
a) Operating Margin				X								X				
b) Return on Invested Capital				X								X				
Factor 4 : Leverage & Coverage (35%)																
a) Debt / EBITDA					X							X				
b) EBITA / Interest				X									X			
c) RCF / Debt					X								X			
Factor 5 : Financial Policy (15%)																
a) Financial Policy					X								X			
Rating:																
a) Indicated Rating from Grid					X								X			
b) Actual Rating Assigned					Ba3								Ba3			

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] Estimated for 12/31/2016. [3] This represents Moody's forward view, not the view of the issuer.

Source: Moody's Financial Metrics™

Ratings

Exhibit 4

Category	Moody's Rating
YESTAR HEALTHCARE HOLDINGS COMPANY LIMITED	
Outlook	Stable
Corporate Family Rating	Ba3
Senior Unsecured	Ba3

Source: Moody's Investors Service

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