

Modern Dental

1H21: Sales/adj.EPS +65%/+1,544%YOY; Raising PT to HK\$13.8

31 August 2021

Key Takeaway

1H21 sales/net profit HK\$1.48bn (+65%YOY) / HK\$240mn (vs. HK\$ 15mn in 1H20) implying a net margin of 16.2%, vs. 1.6% in 1H20. Sales growth accelerated in all regions w/ China +75%YOY (incl. mainland China +113%YOY), Australia +71%YOY, EU +67%YOY and North America +50%YOY. Aligners booked HK\$10mn+ in 1H21. Digital solution cases was 3x that in 1H20. Interim+special dividend were HK 7.5cents (payout ratio 30%) +5.0cents/sh. Our new PT is HK\$13.8. Reiterate BUY.

Sales growth accelerated in all regions and margin expansion – Modern Dental recorded strong sales growth of +65%YOY/15%HOH in 1H21. China grew the fastest at +75%YOY (incl. mainland China +113%YOY), Australia +71%YOY, EU +67%YOY, North America +50%YOY, and other regions +140%YOY. 2Q21 sales growth accelerated to +111%YOY (vs. +33%YOY in 1Q21). 1H21 GM was 52.7% in 1H21 vs. 46.1% in 1H20. EBITDA margin was 25.1%, vs. 12.0% in 1H20. Adjusted net margin was 16.2% vs. 1.6%/7.5% in 1H20/1H19. We believe this margin profile in 1H21 is the new norm and is sustainable. Margins could even improve with better utilization rate and product mix. Strong sales and earnings momentum continues from: 1) global market share amid COVID-19, 2) higher adoption/penetration of digitalization (intra-oral scanning/3D-printing), 3) US turnaround, 4) new mid-market zirconia product in China which carries lower ASP but higher margins, 5) higher utilization rate, 6) new products e.g. aligners, etc.

Potential medical reimbursement inclusion of dental implant products in China – Note that dental implant products (dental implants + abutments + custom-made teeth) in China are currently paid out of pocket. However, a recent set of medical reimbursement standards was proposed in Ningbo (Zhejiang) locally, suggesting reimbursement cap at RMB 3k for domestic (1k products, 2k services), and RMB 3.5k for imported implant products (1.5k materials, 2k services). Note imports dominated the China dental implant market (Osstem+Dentium+Straumann=80% market share followed by Danaher+Dentsply=an additional 10%). These imported dental implants have net margins of 15-25%. On the complementary side, custom-made teeth (each implant needs at least a custom-made tooth to go along) market is very fragmented. Modern Dental owns ~1% market share in China although growing twice speed as the industry. If procurement were to go nationwide, imported implant ASP could come down while volume will surge; custom-made teeth ASP may come down slightly while volume will surge along with the implants. Public hospitals will likely gain market share from private clinics. Note China implant penetration is 10/10k vs. 60/10k in the US, 100-200/10k in Europe and 600/100k in Korea. Modern Dental, in our view, is in pole position to capture/monetize opportunities thanks to its brand/reputation, scale, quality and experience. Note Modern Dental has about 10-12% net margin in China while smaller players have less. If procurement were to come, volume gain should benefit its Chinese business much more than margin loss in terms of absolute earnings.

Our new DCF-derived PT of HK\$13.8 implies a 15.8x 2022E EV/EBITDA and 24.1x 2022E P/E. Reiterate BUY.

Target | Estimate Change

ASIA-PACIFIC excl. Japan | Healthcare Services

RATING	BUY
PRICE	HK\$9.33^
MARKET CAP	HK\$8.9B / \$1.1B
PRICE TARGET (PT)	HK\$13.80 (FROM HK\$12.30)
UPSIDE SCENARIO PT	HK\$18.00
DOWNSIDE SCENARIO PT	HK\$7.50

^Prior trading day's closing price unless otherwise noted.

FY Dec

HKD	2020A	2021E	2022E	2023E
EPS	0.11	↑0.50	↑0.57	↑0.66
Prev.		0.46	0.53	0.59

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MODERN DENTAL (3600 HK)

Estimates				
HK\$	2020A	2021E	2022E	2023E
Rev. (MM)	2,190.2	↑ 2,904.2	↑ 3,256.6	↑ 3,583.2
<i>Previous</i>		2,691.1	3,026.7	3,290.3
Net Profit	107.8	↑ 475.1	↑ 547.8	↑ 628.9
<i>Previous</i>		438.9	507.2	563.7
EPS	0.11	↑ 0.50	↑ 0.57	↑ 0.66
<i>Previous</i>		0.46	0.53	0.59

Market Data	
52-Week Range:	HK\$11.00 - HK\$1.17
Total Entprs. Value	HK\$9.0B
Avg. Daily Value MM (USD)	8.84
Float (%)	33.9%

The Long View

Scenarios

Base Case

Margin expansion and slightly-faster than industry growth;

PT of HK\$13.8 derived from DCF-based valuation.

Upside Scenario

Less ASP pressure;

New product launches and fast sales ramp-up;

New M&As with attractive valuation;

PT of HK\$18.0 derived from DCF-based valuation.

Downside Scenario

Higher ASP downside pressure;

COVID-19 situation worsens, causing more lockdowns;

PT of HK\$7.5 derived from DCF-based valuation.

Investment Thesis / Where We Differ

Modern Dental is a global leading dental prosthetic device provider. We like its global layout and scale, efficient distribution network, cost advantages and consolidation opportunities. We expect Modern Dental to grow at a faster rate than the industry, thanks to higher penetration of its existing and new products, margin expansion from economies of scale and cost-saving strategies.

Catalysts

New product launches/rising penetration;

New M&A deals.

Exhibit 1 - Income statement

Income Statement									
HK\$ '000	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Net sales	2,181,292	2,315,467	2,399,548	2,190,208	2,904,224	3,256,637	3,583,160	3,845,831	4,062,666
COGS	(1,119,780)	(1,236,131)	(1,246,617)	(1,100,220)	(1,365,040)	(1,523,593)	(1,664,791)	(1,776,858)	(1,875,821)
Gross profit	1,061,512	1,079,336	1,152,931	1,089,988	1,539,184	1,733,044	1,918,370	2,068,973	2,186,846
Selling expenses	(265,926)	(275,142)	(294,352)	(251,410)	(319,465)	(358,230)	(394,148)	(423,041)	(446,893)
G&A expenses	(586,525)	(616,797)	(608,278)	(549,383)	(609,887)	(667,611)	(716,632)	(769,166)	(812,533)
R&D expenses	0	(13,761)	(7,447)	(6,434)	(6,935)	(7,776)	(8,556)	(9,183)	(9,701)
Operating income	209,061	173,636	242,854	282,761	602,897	699,427	799,034	867,582	917,718
D&A	90,259	95,478	152,904	135,751	138,139	136,094	133,831	125,926	119,090
EBITDA	299,320	269,114	395,758	418,512	741,036	835,521	932,865	993,508	1,036,808
Other income	23,469	10,797	13,467	26,139	12,428	12,428	12,428	12,428	12,428
Other gains / (loss) net	(1,582)	(12,533)	(17,177)	(150,695)	(5,948)	(5,948)	(5,948)	(5,948)	(5,948)
Finance income	443	547	1,270	1,255	697	948	1,218	1,566	1,873
Finance costs	(28,582)	(51,516)	(37,902)	(33,699)	(24,322)	(22,822)	(21,322)	(19,822)	(18,322)
Share of results of associates	(1,288)	(1,929)	(504)	(1,537)	750	750	750	750	750
Pretax income	201,521	119,002	202,008	124,224	586,502	684,782	786,159	856,556	908,499
Taxes	(44,158)	(35,762)	(41,563)	(16,565)	(111,435)	(136,956)	(157,232)	(171,311)	(181,700)
Effective tax rate	21.9%	30.1%	20.6%	13.3%	19.0%	20.0%	20.0%	20.0%	20.0%
Net income	157,363	83,240	160,445	107,659	475,066	547,826	628,927	685,244	726,799
Minority Interest	(1,992)	2,151	1,112	104	0	0	0	0	0
Net income to common	155,371	85,391	161,557	107,763	475,066	547,826	628,927	685,244	726,799
Diluted EPS (HK\$)	0.156	0.086	0.165	0.112	0.495	0.572	0.657	0.716	0.760
Adjusted net profit to common	155,371	96,951	164,810	224,274	475,066	547,826	628,927	685,244	726,799
Adjusted diluted EPS (HK\$)	0.156	0.097	0.168	0.233	0.495	0.572	0.657	0.716	0.760
Diluted sh o/s (000)	998,520	997,151	980,162	961,914	959,428	956,941	956,941	956,941	956,941
Dividend	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
DPS (HK\$)	0.05	0.03	0.05	0.07	0.15	0.17	0.20	0.21	0.23
YOY%	52%	-28%	61%	32%	112%	16%	15%	9%	6%
Dividend payout ratio	30%	34%	32%	30%	35%	35%	35%	35%	35%
Margin Analysis	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Gross margin	48.7%	46.6%	48.0%	49.8%	53.0%	53.2%	53.5%	53.8%	53.8%
Selling expense as % of sales	12.2%	11.9%	12.3%	11.5%	11.0%	11.0%	11.0%	11.0%	11.0%
G&A expense as % of sales	26.9%	26.6%	25.3%	25.1%	21.0%	20.5%	20.0%	20.0%	20.0%
R&D expense as % of sales	0.0%	0.6%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
Operating margin	9.6%	7.5%	10.1%	12.9%	20.8%	21.5%	22.3%	22.6%	22.6%
EBITDA margin	13.7%	11.6%	16.5%	19.1%	25.5%	25.7%	26.0%	25.8%	25.5%
Pretax margin	9.2%	5.1%	8.4%	5.7%	20.2%	21.0%	21.9%	22.3%	22.4%
Net margin	7.1%	3.7%	6.7%	4.9%	16.4%	16.8%	17.6%	17.8%	17.9%
Adjusted net margin	7.1%	4.2%	6.9%	10.2%	16.4%	16.8%	17.6%	17.8%	17.9%
% YOY Change	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Net sales	33%	6%	4%	-9%	33%	12%	10%	7%	6%
Gross profit	21%	2%	7%	-5%	41%	13%	11%	8%	6%
Selling expense	44%	3%	7%	-15%	27%	12%	10%	7%	6%
G&A expense	17%	5%	-1%	-10%	11%	9%	7%	7%	6%
R&D expense	NA	NA	-46%	-14%	8%	12%	10%	7%	6%
Operating income	7%	-17%	40%	16%	113%	16%	14%	9%	6%
EBITDA	12%	-10%	47%	6%	77%	13%	12%	7%	4%
Pretax income	32%	-41%	70%	-39%	372%	17%	15%	9%	6%
Net income	53%	-45%	89%	-33%	341%	15%	15%	9%	6%
Adjusted net income	53%	-38%	70%	36%	112%	15%	15%	9%	6%
Adjusted diluted EPS	52%	-38%	73%	39%	112%	16%	15%	9%	6%
Diluted shares outstanding	1%	0%	-2%	-2%	0%	0%	0%	0%	0%

Source: Company data, Jefferies estimates (E)

Company Description

Modern Dental

Modern Dental is a global dental prosthetic device provider with two major product lines: fixed prosthetic devices such as crowns and bridges; and removable prosthetic devices such as removable dentures.

Company Valuation/Risks

Modern Dental

Our PEG based price target for Modern Dental is HK\$13.8. Risks: goodwill impairment, ASP pressure, competition, M&A integration risks.

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(Article 3(1)e and Article 7 of MAR)

Recommendation Completion	August 30, 2021 , 22:41 ET.
Recommendation Distributed	August 30, 2021 , 22:41 ET.

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Rating and Price Target History for: Modern Dental Group (3600 HK) as of 08-27-2021



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D: Dropped Coverage

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Distribution of Ratings						
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BUY	1843	63.44%	165	8.95%	28	1.52%
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