

Euroeyes

Improving Fundamentals and a Much Better Outlook, Upgrade to BUY

18 March 2021

Key Takeaway

We are upgrading Euroeyes to BUY with a revised PT of HK\$18 on the back of: 1) improving fundamentals (its business is largely out of the woods in terms of COVID-19, plus a lower, yet sustainable, selling expense ratio) and 2) a much better outlook (sales and earnings growth to accelerate in 2021E with operating leverage to follow from higher utilization rate, new clinics/ramp-up, partnerships and potential M&As).

Fundamentals improvement seen in 2020 albeit COVID-19 – Euroeyes showed its defensive traits under harsh COVID-19 environment and even went against the tide. Its sales in 2020 was HK\$474mn (+10%YOY) and adjusted net profit was HK\$71mn (+40%YOY), implying an improved net margin of 15.2% vs. 11.8%. The operating leverage largely comes from 1) improved gross margin (45.2% vs. 2019: 41.4%) from better utilization rate and country mix, and 2) better operating efficiency especially selling expense ratio (9.7% vs. 14.0% in 2019). More importantly, this lower selling expense ratio is sustainable and could go even lower as its key user acquisition/marketing channel is by the ‘word of mouth’. Sales growth was strong across the board with Germany +15%YOY and Denmark +20%YOY. China sales was -5%YOY, however, in 2020, but management mentioned it is largely due to COVID-19 lockdown, which had operations suspended for three and a half months.

Much better outlook and growth profile – We note 4Q20 was one of the best quarters for Euroeyes with HK\$35mn in net earnings and a net margin of 23.2%. We expect utilization rate to reach 30-40% over the next few years from 4Q’s 28.7%. Management expects the strong momentum to carry into 2021E. Furthermore, we expect sales growth to accelerate to +41%YOY including the contribution from the ramp up of two new consultation centers in Germany and its Beijing East clinic, which has just met breakeven point late 2Q20 after commencement in late 3Q19. Note that there are two brand-new clinics in China (Chongqing and Shanghai Pudong), which could be meaningful contributors to the region soon. Recent partnership with iKang would also bring cross-selling synergies / new users in additional to current growth profile. Last but not least, the company continues to open-minded in terms of M&As. In terms of bottom line, we expect +92%YOY in 2021E as margin expansion continues from operation efficiencies.

Our stance – We believe ophthalmology is a key under-diagnosed and under-treated area with much unmet need. With aging population, healthcare awareness and higher disposable income, Euroeyes can be the go-to platform for eye surgeries (incl. myopia, high myopia, hyperopia, astigmatism, keratoconus, cataract and presbyopia, especially the use of lens exchanges and ICLs).

Valuation – Our valuation of HK\$18 implies 20x our 2021E EV/EBITDA and 16x our 2022E EV/EBITDA.

Risks – Key man risk, expansion uncertainty, pricing pressure, follow-up and related risks (i.e., adverse effect post-surgery, liability, etc.), regulatory risks, competition, and execution risks.

Rating | Target | Estimate Change

ASIA-PACIFIC excl. Japan | Healthcare Services

RATING	↑ BUY (FROM HOLD)
PRICE	HK\$8.90 [^]
MARKET CAP	2.9B / \$377.3M
PRICE TARGET (PT)	HK\$18.00 (FROM HK\$5.80)
UPSIDE SCENARIO PT	HK\$26.00
DOWNSIDE SCENARIO PT	HK\$6.50

[^]Prior trading day’s closing price unless otherwise noted.

FY Dec				
HKD	2020A	2021E	2022E	2023E
EPS	↑HK \$0.18	↑HK \$0.34	↑HK \$0.45	HK\$0.58
Prev.	HK\$0.04	HK\$0.08	HK\$0.16	

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EUROEYES (1846 HK)

Estimates				
HK\$	2020A	2021E	2022E	2023E
Rev. (MM)	↑ HK\$473.8	↑ HK\$668.9	↑ HK\$807.1	HK\$930.3
<i>Previous</i>	HK\$86.8	HK\$226.3	HK\$452.6	
EBITDA (MM)	↑ HK\$189.2	↑ HK\$284.0	↑ HK\$341.2	HK\$407.4
<i>Previous</i>	HK\$84.0	HK\$96.8	HK\$125.7	
Net Profit	↑ HK\$65.6	↑ HK\$125.8	↑ HK\$170.3	HK\$217.9
<i>Previous</i>	HK\$12.2	HK\$27.7	HK\$52.6	
EPS	↑ HK\$0.18	↑ HK\$0.34	↑ HK\$0.45	HK\$0.58
<i>Previous</i>	HK\$0.04	HK\$0.08	HK\$0.16	

Market Data	
52-Week Range:	HK\$10.64 - HK\$3.65
Total Entprs. Value	HK\$2.2B
Avg. Daily Value MM (USD)	0.39
Float (%)	36.4%

The Long View

Scenarios

Base Case

Ramp up and operating leverage from new clinics;
Steady expanding network of clinics in China;
PT of HK\$18 from EV/EBITDA based valuation

Upside Scenario

Stronger demand for premium vision correction/
cataract/DR services;
Faster ramp up of new clinics;
Faster clinics expansion;
PT of HK\$26 from EV/EBITDA based valuation

Downside Scenario

Soft demand for premium vision correction/cataract/
DR services;
Longer breakeven period for new clinics;
Delay of clinic acquisitions;
PT of HK\$6.5 from EV/EBITDA based valuation

Investment Thesis / Where We Differ

The unique value proposition is that Euroeyes flies its very experienced surgeons from Europe to China to perform surgeries. We believe ophthalmology is a key under-diagnosed and under-treated area with much unmet need. With aging population, healthcare awareness and higher disposable income, Euroeyes can be the go-to platform for eye surgeries (for myopia, high myopia, hyperopia, astigmatism, keratoconus, cataract and presbyopia, including the use of lens exchange and ICL).

Catalysts

New clinics organically and/or inorganically;
Cross-selling and synergies with partners

Exhibit 1 - FY20 results review

FY20 YOY% and 2H20 HOH%						
(HK\$ '000)	FY20	FY19	YOY%	2H20	1H20	HOH%
Net sales	473,818	429,692	10%	284,985	188,833	51%
COGS	(259,718)	(251,971)	3%	(146,505)	(113,213)	29%
Gross profit	214,100	177,721	20%	138,480	75,620	83%
Selling expenses	(46,044)	(60,209)	-24%	(23,754)	(22,290)	7%
G&A expenses	(60,491)	(45,870)	32%	(34,087)	(26,404)	29%
Operating income	107,565	71,642	50%	80,639	26,926	199%
D&A	81,684	66,248	23%	34,608	32,726	6%
EBITDA	189,249	137,890	37%	115,247	59,652	93%
Listing expenses	0	(42,219)		0	0	
Other gains / (loss) net	3,492	1,001	249%	2,851	641	345%
Finance income	2,517	2,466	2%	199	2,318	-91%
Finance costs	(14,926)	(11,566)	29%	(11,163)	(3,763)	197%
Pretax income	98,648	21,324	363%	72,526	26,122	178%
Taxes	(34,575)	(25,010)	38%	(25,132)	(9,443)	166%
Effective tax rate	35%	117%	-70%	35%	36%	-4%
Net income	64,073	(3,686)		47,394	16,679	184%
Minority Interest	1,507	246	513%	19	1,488	-99%
Net income to common	65,580	(3,440)		47,413	18,167	161%
Diluted EPS (HK\$)	0.175	(0.013)		0.144	0.055	161%
Adjusted net profit to common	72,121	50,529	43%	53,895	18,226	196%
Adjusted diluted EPS (HK\$)	0.192	0.197	-3%	0.137	0.055	147%
Diluted sh o/s (000)	375,643	256,518	46%	328,770	329,160	0%
Margin Analysis						
	FY20	FY19	Delta	2H20	1H20	Delta
Gross margin	45.2%	41.4%	3.8%	48.6%	40.0%	8.5%
Selling expense as % of sales	9.7%	14.0%	-4.3%	8.3%	11.8%	-3.5%
G&A expense as % of sales	12.8%	10.7%	2.1%	12.0%	14.0%	-2.0%
Operating margin	22.7%	16.7%	6.0%	28.3%	14.3%	14.0%
EBITDA margin	39.9%	32.1%	7.9%	40.4%	31.6%	8.8%
Pretax margin	20.8%	5.0%	15.9%	25.4%	13.8%	11.6%
Net margin	13.8%	-0.8%	14.6%	16.6%	9.6%	7.0%
Adjusted net margin	15.2%	11.8%	3.5%	18.9%	9.7%	9.3%
Revenue and GM						
(HK\$ '000)	FY20	FY19	YOY%	2H20	1H20	HOH%
Revenue	473,818	429,692	10%	284,985	188,833	51%
Germany	304,788	265,160	15%	175,324	129,464	35%
China	108,114	113,415	-5%	71,694	36,420	97%
Denmark	60,916	50,973	20%	37,967	22,949	65%
	FY20	FY19	Delta	2H20	1H20	Delta
Gross margin	45.2%	41.4%	3.8%	48.6%	40.0%	8.5%
Germany	51.1%	47.5%	3.6%	53.1%	48.3%	4.8%
China	30.8%	31.3%	-0.5%	40.0%	12.6%	27.5%
Denmark	42.8%	32.7%	10.1%	45.9%	37.5%	8.4%
Key balance sheet items and working capital						
(HK\$ '000)	FY20	FY19	YOY%			
Cash and cash equivalent	761,894	787,025	-3%			
ST Bank borrowings	2,021	1,893	7%			
LT Bank Borrowings	5,101	6,456	-21%			
Net cash	754,772	778,676	-3%			
Inventory days	47	44	7%			
AR days	3	3	-8%			
AP days	32	30	8%			

Source: Company data

Exhibit 2 - Income statement

Income Statement									
HK\$ '000	2017	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Net sales	322,619	374,828	429,692	473,818	668,930	807,133	930,342	1,043,187	1,145,288
COGS	(23,848)	(25,545)	(251,971)	(259,718)	(342,689)	(396,441)	(435,772)	(464,060)	(482,224)
Gross profit	114,549	151,952	177,721	214,100	326,241	410,691	494,570	579,126	663,063
Selling expenses	(49,522)	(48,240)	(60,209)	(46,044)	(53,514)	(64,571)	(74,427)	(83,455)	(91,623)
G&A expenses	(15,225)	(23,322)	(45,870)	(60,491)	(73,582)	(80,713)	(83,731)	(83,455)	(80,170)
Operating income	49,801	80,391	71,642	107,565	199,144	265,407	336,412	412,217	491,270
D&A	49,400	52,716	66,248	81,684	84,807	75,811	71,021	69,238	69,609
EBITDA	99,202	133,106	137,890	189,249	283,952	341,219	407,433	481,454	560,879
Listing expenses	0	(10,557)	(42,219)	0	0	0	0	0	0
Other gains / (loss) net	72,312	1,326	1,001	3,492	2,000	2,000	2,000	2,000	2,000
Finance income	0	192	2,466	2,517	3,024	3,618	4,361	5,197	6,221
Finance costs	(11,054)	(7,390)	(11,566)	(14,926)	(14,926)	(14,926)	(14,926)	(14,926)	(14,926)
Pretax income	111,059	63,962	21,324	98,648	189,243	256,099	327,847	404,488	484,565
Taxes	(36,278)	(26,524)	(25,010)	(34,575)	(66,327)	(89,760)	(114,907)	(141,768)	(169,834)
Effective tax rate	32.7%	41.5%	117.3%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Net income	74,781	37,438	(3,686)	64,073	122,915	166,339	212,940	262,719	314,730
Minority Interest	1,187	(3,996)	246	1,507	2,891	3,912	5,008	6,179	7,402
Net income to common	75,967	33,442	(3,440)	65,580	125,806	170,252	217,949	268,898	322,133
Diluted EPS (HK\$)	2.317	0.144	(0.013)	0.175	0.335	0.453	0.580	0.715	0.857
Adjusted net profit to common	22,850	43,999	50,529	72,121	125,806	170,252	217,949	268,898	322,133
Adjusted diluted EPS (HK\$)	0.697	0.189	0.197	0.192	0.335	0.453	0.580	0.715	0.857
Diluted sh o/s ('000)	32,791	233,012	256,518	375,643	375,912	375,912	375,912	375,912	375,912
Margin Analysis									
Gross margin	35.5%	40.5%	41.4%	45.2%	48.8%	50.9%	53.2%	55.5%	57.9%
Selling expense as % of sales	15.4%	12.9%	14.0%	9.7%	8.0%	8.0%	8.0%	8.0%	8.0%
G&A expense as % of sales	4.7%	6.2%	10.7%	12.8%	11.0%	10.0%	9.0%	8.0%	7.0%
Operating margin	15.4%	21.4%	16.7%	22.7%	29.8%	32.9%	36.2%	39.5%	42.9%
EBITDA margin	30.7%	35.5%	32.1%	39.9%	42.4%	42.3%	43.8%	46.2%	49.0%
Pretax margin	34.4%	17.1%	5.0%	20.8%	28.3%	31.7%	35.2%	38.8%	42.3%
Net margin	23.5%	8.9%	-0.8%	13.8%	18.8%	21.1%	23.4%	25.8%	28.1%
Adjusted net margin	7.1%	11.7%	11.8%	15.2%	18.8%	21.1%	23.4%	25.8%	28.1%
% YOY Change									
Net sales	22%	16%	15%	10%	41%	21%	15%	12%	10%
Gross profit	32%	33%	17%	20%	52%	26%	20%	17%	14%
Selling expense	24%	-3%	25%	-24%	16%	21%	15%	12%	10%
G&A expense	11%	53%	97%	32%	22%	10%	4%	0%	-4%
Operating income	51%	61%	-11%	50%	85%	33%	27%	23%	19%
EBITDA	31%	34%	4%	37%	50%	20%	19%	18%	16%
Pretax income	301%	-42%	-67%	363%	92%	35%	28%	23%	20%
Net income	266%	-56%	-110%	-2006%	92%	35%	28%	23%	20%
Adjust net income	10%	93%	15%	43%	74%	35%	28%	23%	20%
Diluted EPS	264%	-94%	-109%	-1402%	92%	35%	28%	23%	20%
Diluted shares outstanding	1%	611%	10%	46%	0%	0%	0%	0%	0%

Source: Company data, Jefferies estimates (E)

Company Description

Euroeyes

Euroeyes performs vision correction surgeries and has a leading market share in Germany and Denmark. Services offered include treatment of myopia, high myopia, hyperopia, astigmatism, keratoconus, cataract and presbyopia. The company entered China in 2013 and is now running six clinics over five cities.

Company Valuation/Risks

Euroeyes

Our EV/EBITDA based PT for Euroeyes is HK\$18. Risks: Key man risk, expansion uncertainty, pricing pressure, follow-up and related risks (i.e. adverse effect post-surgery, liability, etc.), regulatory risks, competition, and execution risks.

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

Recommendation Published	March 17, 2021 , 15:02 ET.
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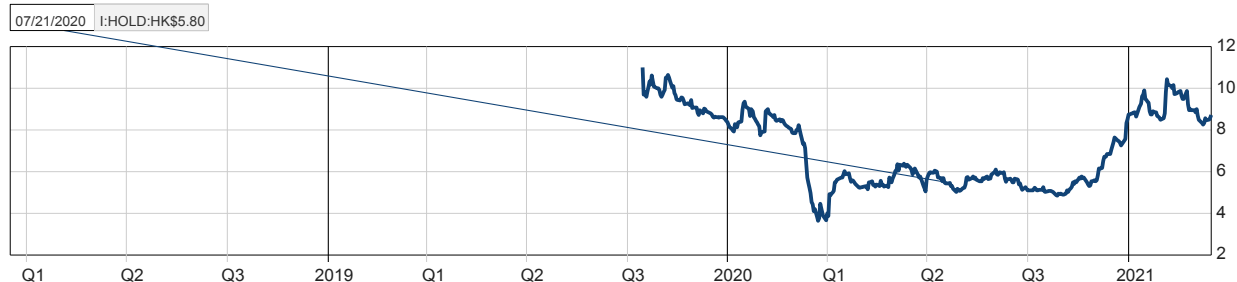
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Rating and Price Target History for: EuroEyes International Eye Clinic Ltd (1846 HK) as of 03-16-2021



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

Distribution of Ratings

Distribution of Ratings						
			IB Serv./Past12 Mos.		JIL Mkt Serv./Past12 Mos.	
	Count	Percent	Count	Percent	Count	Percent
BUY	1632	60.71%	168	10.29%	23	1.41%
HOLD	926	34.45%	22	2.38%	6	0.65%
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