

Osstem Implant (048260)

12M rating **BUY (Maintain)**
12M TP **W44,000** from W34,000
Up/downside **+22%**

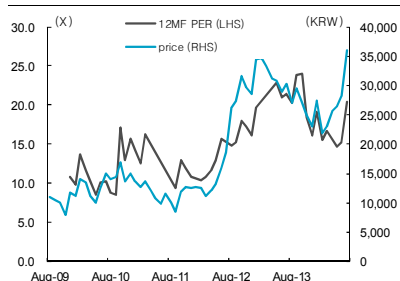
Stock Data

KOSPI (Jul 23, pt)	2,028
Stock price (Jul 23, KRW)	35,950
Market cap (USD mn)	499
Shares outstanding (mn)	14
52-Week high/low (KRW)	35,950/21,050
6M avg. daily turnover (USD mn)	7.2
Free float / Foreign ownership (%)	74.8/22.9
Major shareholders (%)	
Gyu-Ok Choi and 6 others	25.2
OrbiMed Advisors LLC and 2 others	6.8

Performance

	1M	6M	12M
Absolute (%)	27.7	30.5	15.6
Relative to Kospi (%p)	25.0	26.3	9.1

12MF PE trend



Source: WISEfn consensus

Brisker domestic market

Domestic market getting hotter again on health insurance coverage

Starting from July, Koreans aged 75 or older are granted health insurance coverage for dental implants for a maximum of two teeth for the rest of their life. Patients pay half the medical fees with the remainder covered by insurance. Total fees for dental implants are split into procedure and materials, and insurance payments are applied accordingly. For example, if a total W1.2mn is spent for a tooth (W1mn procedure, W0.2mn materials), patients would pay W0.6mn (W0.5mn and W0.1mn). What is noteworthy here is the distinction of material costs. Until now, costs for procedure and materials were combined in a lump sum. But material costs are now separate. This would be a plus for Osstem Implant (Osstem) in terms of consumers' greater discretion over material choices and the narrow price gap with the competition (Table 1). As the price gap seems insignificant, more patients will likely choose Osstem products with its more popular brand. Osstem that commands 45% of the domestic market has distinguished its brand by reinforcing marketing instead of joining the price-cut race led by late entrants.

Pleasant operating conditions formed in Korea and overseas

The Ministry of Health & Welfare plans to expand the national insurance coverage for dental implants to patients aged 70 or older from July 2015 and then down to 65 from July 2016. As of 2014, there are 6.39mn senior citizens aged 65 years and their weighting in the population is rising fast. The insurance coverage for dental implants should trigger the formation of a related market worth W50bn (conservative) assuming 2% of the elderly population choose the procedure. Thus, a future growth story will likely unfold in a way different from the past that was driven by 21 overseas subsidiaries. Domestic and overseas sales should each amount to W120bn, up 14% YoY and 8% YoY, respectively, in 2014F. As overseas subsidiaries reorganize operations, the overseas sales growth will become slower. But the shakeup is a must to improve margins and the main overseas subsidiaries in China and the US should enjoy solid growth in 2015. We peg 2Q14F sales at W60bn (+6% YoY) and OP at W6.5bn (+140% YoY).

Lift TP as earnings improve in a vigorous domestic market

We lift the TP 30% from W34,000 to W44,000 (29.4x 12MF PE). Our target PE is a 20% premium to 24.5x average of Nobel and Straumann. We believe Osstem deserves a higher valuation over rivals given the following. 1) The company has an overwhelming presence in China's market that features high growth visibility. 2) Its earnings growth driven by the lively domestic market sets it apart from global players whose growth has stagnated. However, the management was recently

Yr to Dec	Sales (W bn)	OP (W bn)	NP (W bn)	EPS (KRW)	% chg (YoY)	EBITDA (W bn)	PE (x)	EV/EBITDA (x)	PB (x)	ROE (%)	DY (%)
2012A	201	20	6	439	10.6	25	65.1	18.2	5.5	9.2	-
2013A	216	19	10	699	59.2	24	33.0	15.3	3.9	12.7	-
2014F	240	28	19	1,335	91.0	33	26.9	16.7	5.0	20.5	-
2015F	270	34	24	1,690	26.6	40	21.3	13.6	4.0	21.0	-
2016F	300	39	27	1,925	13.9	46	18.7	11.7	3.3	19.6	-

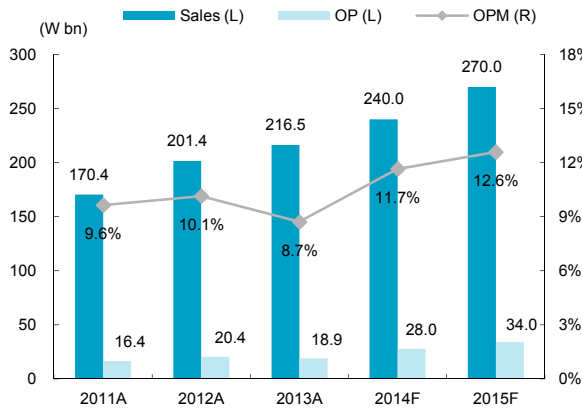
Note: NP and EPS attributed to controlling interest

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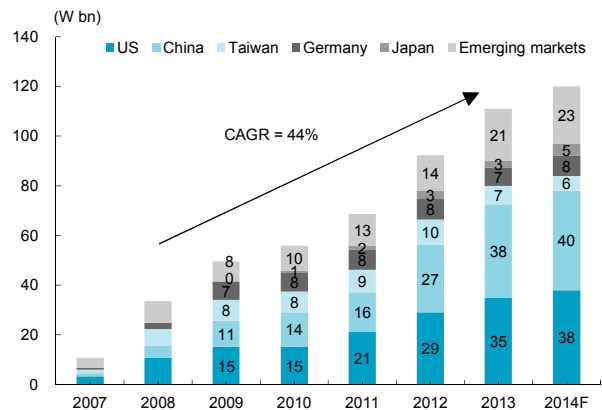
charged by the prosecutor's office for embezzlement and breach of trust. As such, unquantifiable owner risks and uncertainties will likely remain for a considerable time until a verdict is reached. We shall closely monitor the upcoming trial's impact on shareholder value.

Figure 1. Annual earnings



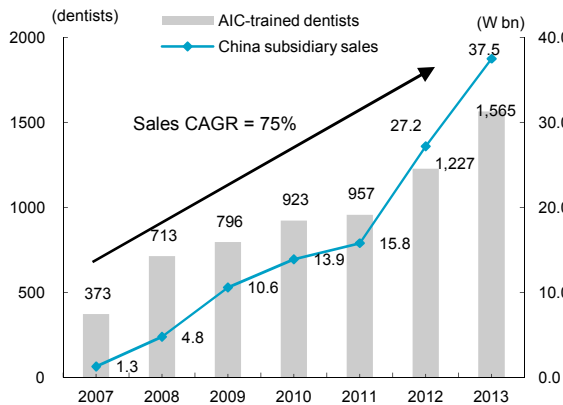
Source: Korea Investment & Securities

Figure 2. Sales at overseas subsidiaries



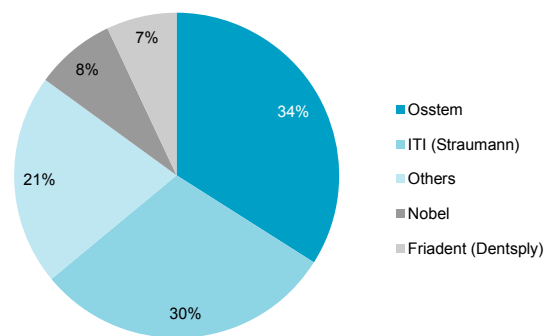
Source: Korea Investment & Securities

Figure 3. Sales at Chinese subsidiary and dentists who completed AIC training program



Note: Cumulative number of dentists who completed the AIC program is 6,694
Source: Company data, Korea Investment & Securities

Figure 4. China implant market breakdown



Source: Company data, Korea Investment & Securities

Figure 5. Global market share breakdown

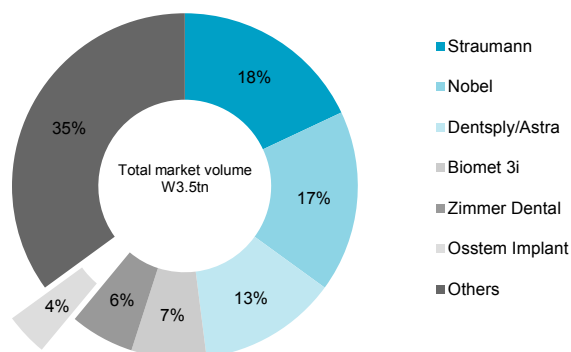
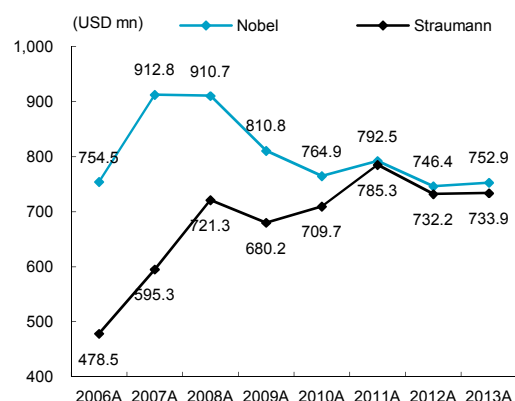


Figure 6. Sales at competitors



Note: As of 2012

Source: Company data

Source: Bloomberg, Korea Investment & Securities

Table 1. Health insurance coverage for domestic dental implant operations (per tooth)

	Before coverage	Under coverage
Osstem	W1.2mn Procedure: ? Materials: ?	W0.6mn Procedure: W1mn * 50% = W0.5mn Material: W0.2mn * 50% = W0.1mn
Competitor	W1.13mn Procedure: ? Materials: ?	W565,000 Procedure: W1mn * 50% = W0.5mn Materials: W0.13mn * 50% = W65,000
Price gap	W70,000	W35,000

Estimated insurance fees: Avg. material costs of W0.2mn (W0.13mn-0.27mn range) * two teeth per patient * 2% of 6.39mn elderly = W51.1bn

Note: Insurance coverage for elderly aged 75 or older started from July 2014 and is scheduled to be lowered to 70 from July 2015 and 65 from July 2016

Source: Korea Investment & Securities

Table 2. Revised earnings estimates

(W bn, %, %p)

	2014F			2015F		
	Previous	Revised	Chg.	Previous	Revised	Chg.
Sales	250.0	240.0	(4.0)	290.0	270.0	(6.9)
OP	25.0	28.0	12.0	36.0	34.0	(5.6)
OPM	10.0	11.7	1.7	12.4	12.6	0.2
NP	15.0	19.0	26.7	24.0	24.0	0.0

Source: Korea Investment & Securities

Company overview & Glossary

Osstem Implant is the domestic no.1 implant manufacturer and takes up 45% of the domestic market. In the 1990s, implants that are similar to natural teeth and have strong masticatory force started to replace dentures and bridges. The domestic market grew fast in the favorable conditions of rising national income and an aging society. Sales CAGR for seven years (2001 to 2008) reached 41% as the market expanded. However, with the domestic market maturing and more competitors denting earnings, sales and margins peaked in 2008 and entered a downslide. Instead, growth in overseas markets such as China has come to the fore. Currently, the domestic implant market size is ~W240bn and ~40 companies compete.

Balance sheet

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	193	207	213	229	245
Cash & cash equivalents	32	42	41	43	45
Accounts & other receivables	81	84	91	97	105
Inventory	56	59	60	65	69
Non-current assets	76	93	99	105	110
Investment assets	3	1	1	1	2
Tangible assets	45	58	61	63	65
Intangible assets	5	6	6	7	8
Total assets	269	300	312	333	355
Current liabilities	176	187	179	175	168
Accounts & other payables	12	18	20	22	25
ST debt & bonds	86	74	72	70	68
Current portion of LT debt	15	27	30	33	35
Non-current liabilities	0	2	4	6	7
Debentures	0	2	4	6	7
LT debt & financial liabilities	10	19	20	20	19
Total liabilities	190	214	209	208	203
Controlling interest	73	83	102	126	153
Capital stock	7	7	7	7	7
Capital surplus	54	54	54	54	54
Other reserves	(12)	(12)	(12)	(12)	(12)
Retained earnings	23	32	51	75	103
Minority interest	5	3	1	(0)	(1)
Shareholders' equity	78	86	103	126	152

Income statement

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	201	216	240	270	300
COGS	80	85	88	99	110
Gross profit	121	131	152	171	190
SG&A expenses	101	112	124	137	151
Operating profit	20	19	28	34	39
Financial income	5	6	5	6	6
Interest income	0	1	1	1	1
Financial expenses	14	13	9	9	9
Interest expenses	4	4	4	4	4
Other non-operating profit	(1)	(2)	(1)	(1)	(1)
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	10	11	22	29	34
Income taxes	5	3	5	7	7
Net profit	5	8	17	22	27
Net profit of controlling interest	6	10	19	24	27
Other comprehensive profit	(1)	(0)	0	0	0
Total comprehensive profit	4	8	17	22	27
Total comprehensive profit of controlling interest	6	10	19	24	27
EBITDA	25	24	33	40	46

Changes to recommendation and price target**Cash flow**

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operations	(8)	32	6	13	14
Net profit	5	8	17	22	27
Depreciation	4	4	4	5	6
Amortization	0	1	1	1	1
Net incr. in W/C	(16)	11	(15)	(15)	(19)
Others	(1)	8	(1)	0	(1)
C/F from investing	(17)	(21)	(10)	(12)	(12)
Capex	(10)	(17)	(7)	(7)	(8)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(3)	(2)	(0)	(0)	(0)
Net incr. in intangible assets	(4)	(2)	(2)	(2)	(2)
Others	0	0	(1)	(3)	(2)
C/F from financing	39	0	3	1	(0)
Incr. in equity	9	0	0	0	0
Incr. in debt	30	(1)	1	(0)	(1)
Dividends	0	0	0	0	0
Others	0	1	2	1	1
C/F from others	(0)	(0)	0	0	0
Increase in cash	14	11	(2)	2	2

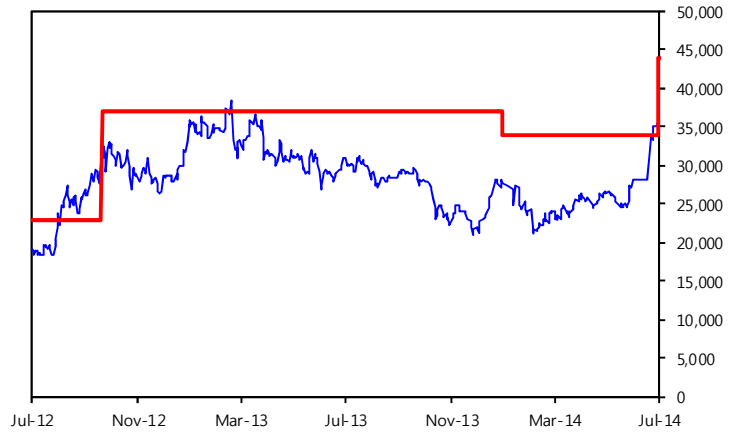
Note: K-IFRS (consolidated)

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
Per-share data (KRW)					
EPS	439	699	1,335	1,690	1,925
BPS	5,169	5,853	7,188	8,879	10,804
DPS	0	0	0	0	0
Growth (%)					
Sales growth	18.2	7.5	10.9	12.5	11.1
OP growth	24.3	(7.7)	48.2	21.6	14.7
NP growth	11.5	62.5	91.1	26.6	13.9
EPS growth	10.6	59.2	91.0	26.6	13.9
EBITDA growth	16.0	(4.0)	41.3	20.6	14.1
Profitability (%)					
OP margin	10.1	8.7	11.7	12.6	13.0
NP margin	3.0	4.6	7.9	8.9	9.1
EBITDA margin	12.2	10.9	13.9	14.9	15.3
ROA	1.9	2.8	5.6	7.0	7.7
ROE	9.2	12.7	20.5	21.0	19.6
Dividend yield	-	-	-	-	-
Dividend payout ratio	0.0	0.0	0.0	0.0	0.0
Stability					
Net debt (W bn)	45	36	38	34	28
Debt/equity ratio (%)	122.6	110.3	92.9	76.1	62.1
Valuation (x)					
PE	65.1	33.0	26.6	21.0	18.4
PB	5.5	3.9	4.9	4.0	3.3
EV/EBITDA	18.2	15.3	16.4	13.4	11.5

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Osstem Implant (048260)	08-20-12	BUY	W23,000
	10-14-12	BUY	W37,000
	01-23-14	BUY	W34,000
	07-23-14	BUY	W44,000



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Prepared by: Jee Hyung Han

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