

Mingyuan: Thanks Doc, no cancer

Kennedy Tsang
(852) 2533 3713
kennedytsang@softbank.com

Recommendation: Not Rated

China Pharmaceuticals

Price	HK\$0.78	Yield (12/06A)	2.5%
12 mth range	HK\$0.63-0.99	ROE (12/06A)	16.0%
Market cap.	US\$271.2m	Net gearing (12/06A)	Cash
No. shares o/s	2712.4m	Net debt/sh. (12/06A)	n/a
Daily t/o, 3 mth	US\$1.5m	BV/sh. (12/06A)	0.21
Free float %	39.9%	Consensus EPS	
Major shareholder	Mr Yao & Mr Lu (47.4%)	- 12/07F	HK\$0.050
Ticker	0233.HK/ 233 HK	- 12/08F	HK\$0.074

Key points:

- MY Medicare's C-12 protein chip is the only cancer screener able to diagnose up to 10 types of cancer at once.
- New partnership with China Life Insurance, China's biggest insurer will further drive sales of C-12 protein chips.
- Exclusive 20-year license to distribute Human Papilloma Virus (HPV) DNA screener in Asia Pacific and China will be promising new revenue source.
- Trading at 15.6x FY12/07F P/E and 10.5x FY12/08F P/E consensus, a 22% and 32% discount to peers.

Business model. Listed on the HKEx in Sep 2002, Mingyuan Medicare Development Company Limited (MY Medicare) is a Hong Kong-based pharmaceutical holding company operating in China. It derives revenue mainly from: (i) sales of C-12 protein chips to 600 hospitals and wholesale distributors; and (ii) sales of human papilloma virus (HPV) cancer screening kits, manufactured and distributed in China. The company has its own R&D division and two factories near Shanghai.

Focus on pharmaceuticals. In FY12/06A, MY Medicare derived HK\$150.9m from sales of C12 protein chips, accounting for 93.8% of overall revenues. Of this, 91.0% were from sales to distributors (up 10.0% YoY) and 8.0% (down 6.0% YoY) from life insurance companies. The company disposed of its information technology product and services division as well as property business in 2H FY12/06, to focus solely on the pharmaceutical sector.

Unique early cancer detection system. C-12, is a protein chip system used for the detection of multi-tumor markers. It was developed by MY Medicare's wholly-owned subsidiary, Shanghai HealthDigit Company Limited (HealthDigit). Capable of detecting up to 12 tumor markers at the same time, C-12 protein chips can assist in the detection of 10 cancers at their asymptomatic stage. With their success rate for early detection of about 80.0%, they allow early treatment, which significantly improves the chances of recovery. C-12 has three patents registered in China (product, machine, process). The C-12 protein chip can command a gross margin of around 80%.

C-12 has significant advantages. The C-12 protein chip is the only tumor market to detect for multiple types of cancer simultaneously. Other tumor markers detect for specific types of cancer, though they may "indicate the possible presence" of other forms of cancer. The system allows cheaper, faster and more accurate tumor detection, making cancer screening more convenient, accurate and affordable. It has five main applications: 1) assist in cancer diagnosis; 2) assess treatment effects; 3) monitor patient condition; 4) assess prognosis and 5) monitor metastasis. Cancer screening targets mainly high-risk individuals, such as those aged over 45, those with long time exposure to chemicals or family history of cancer or living in high cancer rate regions.

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SFDA Class I Certified. The C-12 protein chip set was awarded the Class 1 Drug Certificate and Manufacturing Certificate by the State Food and Drug Administration (SFDA) in December 2001 and was launched in China in late 2002. Currently, there is no identical product in the market, which gave the company a first mover advantage. HealthDigit continues to integrate its fundamental biochip technology platforms to upgrade the function and range of C-12 protein chips.

The system. C-12 cancer screeners use serum samples imported from overseas for tumor marker detection. The test is based on sensitive chemiluminescence signals detected by a CCD camera. The chip can only be used with a reader produced by MY Medicare. The HD-2001A chip reader captures light signals generated by the protein chip system, processes them and analyzes the data. It retails for about RMB300,000-400,000, with production costs representing 50.0%. At the end of 2006, the company had 406 machines installed across China. The current reading utilization rate per machine averages 10.15x per day, compared with 10.09x in 2004 and 8.15x in 2003. MY Medicare imports components from overseas and assembles the machines in China.

Table 1: Current tumor diagnosis methods

Method	Description
Imaging method	Only able to detect tumors at middle or late stages and locate tumors
Pathology method	Invasive - diagnosis made through examination of tissues and cells
Biochemical method	Measurement of tumor markers

Source: company data

Table 2: Advantages of using C-12

Advantages	Remarks
Parallel detection of multi-tumor markers	12 tumor markers relating to 10 major cancer types are analyzed in a single chip
High throughput	Can analyze up to 42 samples for each kit. Suitable for cancer screening in large population
Miniaturization	Tiny reaction area at 0.5 cm, which requires 100 ul of serum only, much less than in other detection methods
High sensitivity and specificity	Parallel analysis of multi-variants for the detection of a single disease increases accuracy
Fast	2-3 hours to complete analysis of 12 tumor markers for 42 samples
Low cost	1/3 cheaper than current tumor marker detection methods

Source: company data

Huge market potential for cancer markers. According to the WHO, cancer is one of the leading causes of death in 26 countries and areas in the Asia Pacific region, with some 3.5m cases a year, about 2.0m in males and 1.5m in females. China accounted for about 2.8m cases in 2005 with cancer-related deaths estimated at 1.7m. The most common are cancers of trachea, bronchus and lungs (14.3%), stomach (11.5%), colon and rectum (7.6%) liver (6.2%), and oesophagus (2.8%). Most cervical and breast cancer cases occur in developing countries. HPV is the major cause of cervical cancer, with about 114,200 cases and 66,000 deaths a year in Asia Pacific.

China Life deal further strengthens distribution network. Currently, the company's network extends to about 600 hospitals and 13 distributors nationwide. To extend its reach, the company signed a cooperation agreement with China Life Insurance Company Limited, Shanghai Branch (CLS) in December 2006. CLS will package MY Medicare's C-12 protein chip into their "Cancer Care Insurance" product. The insurance product was launched in Shanghai in early March 2007 and will be gradually scaled up to be distributed nationwide. For each policy sold (RMB450/year), MY Medicare will supply one proprietary protein chip as part of the health evaluation process prior to the acceptance of the policy application. With the proliferation of insurance products in China, we expect MY Medicare to benefit substantially from this partnership.

Expanding regionally outside China. The company is studying cooperation prospects in various markets outside China. In 2006, Biomarkers Sdn Bhd.(BIO), its sole and exclusive distributor of C12 protein chips in Malaysia, Indonesia and Brunei, made progress in the promotion and sales of the products. BIO is an affiliate of HSC Medical Center (HSC) in Kuala Lumpur, one of the world's leading one-stop medical, heart and diagnostic center specializing in early detection and treatment of heart diseases. HSC has acquired two C-12 testing machines from MY Medicare and sold 5,000 chips since the beginning of 2007. MY Medicare also plans to enter Singapore, Thailand, Hong Kong and Taiwan and appoint distributors in these regions.

Capacity expansion for C-12 chip production. The company's plant in the Huizhou Economic Zone in Zhejiang province is operating at its full capacity of 1.5m chips/year. Until the launch of a new factory in Fengxian district in Shanghai, its capacity has been temporarily expanded to 2.0m. The new factory, covering about 81,000 sq.m, will have a designed capacity of 8.0m chips/year. Phase I, costing HK\$200.0m with a capacity of 4.0m chips/year, will be operational by Aug 2007. To reach full 8.0m capacity, the company will have to increase its capex by about RMB50.0m probably in 2009.

Strategic acquisition to diversify into cervical cancer screening. In June 2006, MY Medicare's subsidiary Health Digit acquired 51% in Shanghai Weiyi Hospital Investment and Management Co. Ltd for RMB60.0m. Founded in July 2003, Weiyi is mainly engaged in: 1) operation of a 228-bed woman and infant specialty hospital in Shanghai and 2) distribution of DNA HPV diagnostic kits for cervical cancer screening. Weiyi's has a 20-year agreement (starting in June 2006) with Genetel Pharmaceuticals Limited (Genetel), a subsidiary of City University of Hong Kong (City U) to exclusively distribute DNA HPV diagnostic tests in Asia Pacific and China. The DNA HPV diagnostic test kits will be manufactured by Genetel's joint venture with a third party Chinese company, with current production targets between 15,000-25,000 sets a month. Through its subsidiary, MY Medicare assumes all the rights and interests in the distribution of the DNA HPV diagnostic tests. As to the hospital operations, Weiyi Hospital generated a revenue of HK\$10.0m in FY12/06A, accounting for 6.2% of overall turnover. MY Medicare has indicated that they do not plan to diversify significantly into hospital management. The main strategic aim for Weiyi hospital is to set up of a flagship center for cervical cancer screening.

Background on HPV. HPV is a family of over 100 viruses. Some types are associated with tumors of the genital tract including cancer of the cervix. Only over 30% of them can be transmitted through sexual contact. Most genital HPV infections are innocuous but elevate the risk of cervical cancer and may play a role in cancers of the anus, vulva, vagina, oropharynx and penis. Both LR-HPVs and HR-HPVs can cause abnormal cell growth, but generally only the high-risk types of HPVs may lead to cancer.

Huge market. Worldwide, cervical cancer represents about 12.0% of all cancers in women (the second most common cancer) but is commonest in developing countries. Cervical screening is currently seen as the most effective approach to control cervical cancer. According to the WHO, more than 471,000 new cases were diagnosed and 288,000 deaths resulted from cervical cancer worldwide in 2000. About 80.0% of these deaths occurred in developing countries. More than 50,000 Chinese women are dying from cervical cancer each year. HPV infections are among the most common sexually transmitted conditions.

Financial results. In FY12/06A, turnover rose 26.6% YoY to HK\$160.8m, while operating profit jumped 31.8% YoY. Gross margin fell 2.8 pcp YoY to 87.9% with the consolidation of the hospital operations acquired in 2H FY12/06A and a mild ASP decrease in C-12 protien chips. Chip sales totaled 1.5m chips, up 26.1% YoY from FY12/05A. Selling and distribution costs increased 57.5% YoY to HK\$9.2m though it only accounted for 6.0% of revenues. The weak 4.9% YoY increase in net profit to HK\$73.6m was mainly the result of HK\$18.9m taxes (c.f. nil in FY12/05A), though the company has indicated that they will apply for some tax rebates in a bid to recover a portion of the tax expenses. As at 31 Dec 2006, the company was in a net cash position of HK\$163.0m.

Valuation. The stock is trading at 15.6x FY12/07F P/E and at 10.5x FY12/08F consensus P/E, which represent a 22% and 32% discount to peers, respectively.

Corporate governance issues. Founders Yao Yuan and Lu Chung are brothers and direct beneficial owners of MY Medicare. Ming Yuan Holdings Ltd, equally owned by the two, holds 47.4% of MY Medicare. Other substantial shareholders are CITIC Pacific (6.9%) and China Life Trustees (5.0%). The company issued a HK\$200m convertible bond, issued to Deutsche Bank in Jan 2005. Due in 2010, the bonds bear an 8% p.a. interest with an initial conversion price of HK\$0.92. The company does not have a pre-defined dividend policy.

Table 3: Valuation comparison

Company Name	Ticker	Mkt Cap (US\$m)	Price	Cur Yr P/E (x)	Nxt Yr P/E (x)	Est Yield (%)	ROE (%)
Sino-Biopharmaceutical	1177 HK	376	1.25	21.3	19.7	3.1	132.8
China Pharmaceutical	1093 HK	349	1.74	32.4	16.1	0.9	6.6
China Shineway	2877 HK	571	5.40	-	-	-	19.6
C&O Pharmaceutical	COPT SP	164	0.41	25.6	15.8	1.3	38.6
Shangdong XinHua	719 HK	383	2.25	-	-	-	1.7
Shangdong Luoxin	8058 HK	143	1.89	18.2	-	-	32.1
Guangzhou Pharm-H	874 HK	1308	5.51	6.7	-	-	7.5
Hua Han	587 HK	279	2.5	15.0	11.2	0.9	16.3
Average				19.9	15.5	1.8	31.9
MingYuan Medicare	233 HK	271	0.78	15.6	10.5	1.9	16.0

Source: Bloomberg and SBI E2-Capital

Table 4: P&L

Year to Dec (HK\$m)	03A	04A	05A	06A
Turnover	456.0	523.6	127.0	160.8
Cost of sales	(403.1)	(426.7)	(11.7)	(19.5)
Gross profit	52.9	96.8	115.2	141.3
Other income and gains	14.8	15.2	23.4	20.6
Selling and distribution costs	(1.6)	(6.0)	(5.8)	(9.2)
Administrative expenses	(22.4)	(35.3)	(42.0)	(43.6)
Other operating expenses	(2.6)	(5.5)	(13.7)	(2.6)
Operating profit	41.1	9.7	90.8	109.1
Finance costs, net	(1.8)	(2.8)	(5.0)	(16.7)
Interest income	-	-	-	-
Profit before taxation	39.3	72.0	72.1	95.0
Taxation	(3.5)	(4.8)	-	(19.0)
Profit after tax	35.7	67.3	72.1	76.1
Loss attributable to discontinued activities	-	-	(2.1)	(3.1)
Minority interests	(2.0)	0.2	(0.1)	(0.6)
Profit attributable to shareholders	33.7	67.0	70.0	73.0
% chg	-	98.8%	4.5%	4.3%
Dividends	-	-	-	(26.9)

Source: Company data