

China Renji

Xinjiang move points to difficulties

Hold (from Buy)

Financial summary

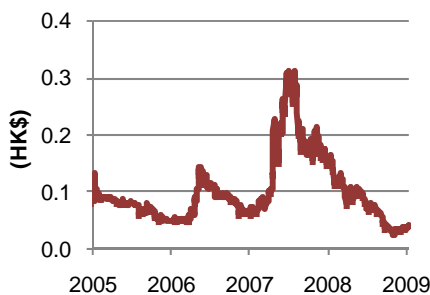
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	9.1	58.5	209.7	280.7	311.9
Net Profit (HK\$m)	(83.0)	12.8	74.8	105.1	132.0
EPS (HK\$m)	(0.018)	0.002	0.007	0.009	0.012
EPS %	n/a	n/a	312.7	40.5	25.6
P/E (x)	n/a	8.8	2.1	1.5	1.2
P/B (x)	0.74	0.13	0.15	0.13	0.12
EV/EBITDA (x)	n/a	10.5	1.2	0.5	0.1
Yield (%)	-	-	-	-	-
ROE (%)	n/a	1.7	6.4	9.1	10.4
ROCE (%)	n/a	n/a	8.5	12.2	13.4
N. Gear. (%)	Cash	2.8	2.4	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	15,7	31,7	(50,1)
Actual price changes (%)	27,3	13,5	(72,4)

	08F	09F	10F
Consensus EPS (HK\$)	0.006	0.011	0.014
Previous forecasts (HK\$m)	68.7	127.3	161.4
Previous EPS (HK\$)	0.006	0.011	0.014

Price Chart



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Ticker:	648 HK	12 mth range:	HK\$.022-0,167
Price:	HK\$0.041	Market cap:	US\$60.95m
Target:	HK\$0.09 (+119)	Daily t/o, 3 mth:	US\$0.2m
		Free float %:	70.5%

Key points:

- * Acquisition of gamma knife operations and assets in Xinjiang Hospital
- * Payment of RMB18.0m through an asset swap involving 411 Gamma Knife Centre [32%] and 455 Gamma Knife Centre [30%], representing a 0.85x P/B
- * We believe Renji overpaid given strong cash flows generated by 411 and 455 Centres
- * Deal highlights Renji's issues such as: 1) capital resource constraints; 2) need to preserve cash on hand and 3) need to expand its operational network
- * Target price revised to HK\$0.09 and downgrade to HOLD, with capital constraints and a lack of catalysts to limit near-term upside

Xinjiang acquisition announced. China Renji (Renji) announced that it had entered into an agreement with an independent third party on 1 Jan 2009 to acquire the entire interest of medical assets and operations of a body gamma knife and head gamma knife centre in Xinjiang. The head gamma knife has been in operation since 2003, while the body gamma knife is newly installed and expected to commence operations in IQ 2009. The facilities, located in the Xinjiang Hospital of Cardio-Cerebral Vascular Diseases (Xinjiang Hospital) in Urumqi, offer radiotherapy treatment services for cancer and cancer related diseases. The hospital has around 400 beds and 500+ staff and is a renowned health institute in China's northwestern region. It cooperates with domestic and international institutes including the German Heart Institute (Berlin), China Northwestern Co-operation Centre and Beijing Hospital of China's Ministry of Health.

Asset swap. Renji will pay for the RMB18.0m deal via an asset swap involving its medical interests in 411 Gamma Knife Centre (32%) and 455 Gamma Knife Centre (30%), both in Shanghai. The net book value of the Xinjiang assets was RMB21.0m as of 30 Nov 2008, while the relevant aforesaid percentages in the Shanghai gamma knife centres totaled RMB18.0m. The acquisition consideration represents 0.85x P/B.

Our view. While the move allows the company to establish a foothold in northwestern China, we are negative on the asset swap since 411 and 455 Gamma Knife Centres are arguably the company's most prized assets. They collectively accounted for 53.4% of Renji's revenues in 1H FY12/08A and are strong cash generators for the company. Meanwhile, the attributable revenue from the Xinjiang Gamma Knife Centre's head gamma knife in 2007 was RMB1.25m (body gamma knife not operational at the time). In a way, the company appears to have sacrificed its current cash flow for future growth opportunities, which we think is negative as we expect the scale and pace of growth of the Xinjiang centre to be limited. Despite the 0.85x P/B consideration, the company overpaid for the acquisition, in our view.

Issues to resolve. The acquisition highlights some of the issues currently faced by Renji:

- Tight capital resources – had about HK\$48.0m in cash at end-Nov 2008, though we expect receivables of HK\$20-25m in the next one to two months;

- Need to preserve capital – we believe that Renji is working on several large scale acquisitions which will require upfront cash considerations and therefore the company is trying to preserve its cash on hand and using alternative methods to undertake smaller acquisitions (such as the asset swap method);
- Need to broaden its operational footprint – Renji faces pressure from would be competitors; and
- Masep acquisition increasingly unlikely – on 22 Sep 2008, Renji announced a framework agreement to acquire Masep, a gamma knife equipment manufacturer with footholds in southeast Asia and North America. With no further news, we believe the deal may fall through, which may be a blessing in disguise for the company, as it had significant execution risks.

Target price cut. The deal will not affect Renji’s FY12/08F earnings but will affect its FY12/09F results via increased minority interest payments. We cut our net profit estimates by 17.4% in FY12/09F and 18.2% in FY12/10F and target price to HK\$0.09, representing FY12/09F 4.0x EV/EBITDA and 9.8x P/E. Despite the upside in terms of the stock price, we downgrade our call to HOLD as we think that capital constraints and the absence of clear catalysts will limit the stock’s near-term upside.

Table 1: P&L

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Revenues	9.1	58.5	209.7	280.7	311.9
Cost of sales	(0.9)	(33.8)	(43.1)	(55.8)	(58.6)
Gross profit	8.2	24.6	166.6	224.9	253.3
Other revenues	5.9	5.0	5.6	6.1	6.7
Distribution expenses	-	-	-	-	-
Administrative expenses	(40.0)	(64.1)	(46.4)	(47.3)	(47.6)
Exceptionals	(16.3)	(13.5)	-	-	-
Finance costs	(3.9)	(26.6)	(24.2)	(14.0)	(8.1)
Share of results from associates	(54.6)	(0.7)	-	-	-
Profit before tax	(100.8)	(75.4)	101.6	169.7	204.3
Tax	-	(1.5)	(24.6)	(41.8)	(46.8)
Profit from continuing operations	(100.8)	(77.0)	77.0	128.0	157.6
Profit from discontinued operations	17.3	93.7	1.8	-	-
Profit for the year	(83.4)	16.8	78.8	128.0	157.6
Minority interest	0.4	(4.0)	(3.9)	(22.8)	(25.6)
Net profit	(83.0)	12.8	74.8	105.1	132.0

Source: Company data, SBI E2-Capital

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