

China Renji: Buys remaining 49% of Er Pao CD&T

Recommendation: BUY (unchanged)

China Healthcare

Price	HK\$0.112	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$0.45 (+302%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$0.063-0.335	05A	(93.6)	(0.022)	na	na	6.8	174.2	-	na	na	Cash
Market cap.	US\$163.7m	06A	(83.0)	(0.018)	(19.3)	na	5.9	546.0	-	na	na	Cash
Daily t/o, 3 mth	US\$1.1m	07F	30.6	0.004	(121.4)	29.9	2.0	25.6	-	7.0	5.2	Cash
Free float %	86.3%	08F	172.7	0.014	275.0	8.0	1.4	4.9	-	22.1	15.4	Cash
Ticker	0648.HK/648 HK	09F	199.7	0.016	15.6	6.9	1.2	4.1	-	19.9	14.96	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -14.4%, -30.5%, +48.7%

Actual price changes (1 mth, 3 mth, 12 mth): -24.4%, -42.2%, +78.8%

Consensus EPS (08F): HK\$0.013

Previous forecasts (07F-09F): (-HK\$6.0m) (-\$0.001), HK\$160.5m (\$0.013), HK\$199.7m (\$0.016)

Key points:

- First acquisition of 2008 - the company will acquire the remaining 49.0% of the CD&T centre at Beijing Er Pao Hospital. Renji bought 51.0% of the centre in Oct 2007.
- Two-tranche deal – a win-win situation for Renji and the vendor, giving Renji a chance to satisfy itself that the newly opened centre is ramping up well before investing further and the vendor to reinforce its confidence in Renji's management.
- Same terms as Oct 2007 acquisition - the HK\$0.25 issue price of consideration shares represents a 125.2% premium to its last closing price (prior to the announcement) of HK\$0.111.
- One-off gains from disposal of non-core assets likely to reverse the 1H FY12/07A net loss of HK\$38.0m and improve the visibility of the contribution of the listco's medical operations. We upgrade our FY12/07F net profit forecast to HK\$30.6m (previously net loss of HK\$6.0m).
- Full consolidation of the Er Pao facility will allow Renji to fully capitalize on its growth potential. We re-iterate our BUY call on Renji with a target price of HK\$0.45. Our target price represents 32.0x FY12/08F P/E on a fully diluted basis.

2nd tranche acquisition of Er Pao. China Renji (Renji) announced its first deal in 2008 after market close on 23 January. The company agreed to acquire from Shanghai Rentung the remaining 49.0% of the CD&T centre at the Main Hospital of the Second Artillery Force (Er Pao) in Beijing. Renji acquired 51.0% of the Er Pao CD&T centre in Oct 2007, after completing the acquisition of Anping Medical, a subsidiary holding all of the listco's medical services operations.

Same terms as 1st tranche acquisition. The terms are essentially the same as under the earlier transaction. Renji will pay a total consideration of RMB71.2m, comprising RMB36.5m in cash and RMB34.7m in 148.6m new shares, at HK\$0.25 each. The issue price, the same as in the initial acquisition, represents a 125.2% premium to the last closing price (prior to the announcement) of HK\$0.111. The cash/share split of the consideration is also the same. On completion of the deal, Shanghai Rentung will hold around 2.43% of Renji's enlarged issued share capital.

Total warranted net profit of RMB20.0m. The vendor will warrant Renji's 49.0% attributable interest of the FY12/08F net profit generated from the CD&T centre to be no less than RMB9.8m. This represents an acquisition valuation of 7.3x FY12/08F P/E, again the same as the initial acquisition. If the warranted net profit is not achieved, the vendor will compensate Renji four times the difference between the warranted and actual net profit in cash, capped at RMB36.5m. Including the warranted net profit for the initial 51% stake, the CD&T facility at Er Pao Hospital will offer a total warranted net profit of RMB20.0m to Renji in FY12/08F.

Two tranche deal a win-win for both parties. In our view, the two-tranche deal is a win-win situation for both parties. Opened in Jun 2007, Er Pao's CD&T centre is a new facility and the arrangement will allowed Renji to monitor its up take before enlarging its investment while the vendor will be able to reinforce its confidence in Renj's commitment to building out its medical operations network before selling.

Table 1: Er Pao CD&T centre acquisition

Definition	Equipment	Tranche 1 stake (%)	Tranche 2 stake (%)	Effective stake (%)	Remarks
Wholly-owned medical equipment	1 x head gamma knife 1 x body gamma knife 1 x linear accelerator 1 x tumour heat therapy system 1 x CT sim scan	51.0	49.0	100.0	n/a
50.0%-owned medical equipment	1 x Pet-CT	51.0	49.0	50.0	Remaining 50.0% is owned by Er Pao Hospital

Source: Company data, SBI E2-Capital

Er Pao ramping up. Given that the centre recorded a net profit of around RMB12.2m in 2H FY12/07, we believe that the total warranted FY12/08F net profit of RMB20.0m is conservative and well within reach. We understand that the centre is presently treating around 85 head patients and 70-80 body patients each month. Management aims to bring the number to 100 for each machine per month. Average fees are currently around RMB20,000/patient.

Background of Beijing Er Pao Hospital's CD&T centre. The hospital, located in Beijing's Western District between Second and Third Ring Roads (closer to Second Ring Road), was the government's 262 Hospital but has been under the private management of Er Pao since 2002. Er Pao currently has 700 beds, which will increase to around 1,000 by end-2009. The 2,000sqm CD&T centre currently offers cancer treatment support but plans to offer healthcheck facilities in future. It has 35 employees and 11 marketing staff. The Er Pao CD&T centre has a high market share, with only three sets of body gamma knives and four sets of head gamma knives in operation in Beijing, suggesting a sustained level of demand for gamma radiotherapy treatment.

Table 2: Renji acquisition summary (since completion of Anping Medical acquisition)

Project	Date	Acquired stake (%)	Consideration	Attributable profit guarantee	Acquisition valuation
Er Pao Hospital CD&T centre (Tranche 1)	Sep 2007	51.0	RMB74.12m (cash + new shares)	RMB10.2m (FY12/08)	7.3x FY12/08F P/E
Er Pao Hospital CD&T centre (Tranche 2)	Jan 2008	49.0	RMB71.22m (cash + new shares)	RMB9.8m (FY12/08)	7.3x FY12/08F P/E
Hefei Hospital	Oct 2007	100.0	RMB46.2m (cash)	RMB5.0m (FY12/07) RMB12.0m (FY12/08)	3.9x FY12/08F P/E
Shenyang PLA 463 Hospital CD&T centre	Nov 2007	100.0	RMB41.0m (cash)	RMB10.0m (07/07-06/08) RMB10.0m (07/08-06/09)	4.1x 07/07-06/08F P/E

Source: Company data, SBI E2-Capital

Non-core asset disposal gains may cover 1H loss. Renji has continued disposing of its non-core assets and businesses and we understand that the generated book gains, estimated at about HK\$40.7m, will come close to cover its 1H FY12/07A net loss of HK\$38.0m, mainly due to a HK\$42.6m one-off impairment charge. In our view, the only swing factor is the timing of the transactions which will determine whether the gains will be booked in FY12/07 or FY12/08. Therefore, Anping Medical's net profit contribution since July can be more clearly displayed in the listco's results. More importantly, the effective completion of asset disposals and Anping Medical's founder taking over as the listco's chairman (see *Anping Medical's founder becomes Chairman (2 Jan 2008)*), will mark the full transformation of Renji from an investment conglomerate to a China-focused healthcare services provider.

Table 3: Non-core business disposal summary (main items)

Item	HKEx announcement	Net proceeds (HK\$m)	Valuation	P&L impact
Disposal of 49% interest in SBI E2-Capital Securities	Y	76.8	~1.0x P/B	nil
Disposal of 5.67% interest in E2-Capital (378 HK)	Y	23.2	~7.6x FY12/06A P/E	HK\$3.9m gain
Disposal of property portfolio	N	~50.0	na	~HK\$1.0m gain
Disposal of garment business	Y	~20.0	~1.0x P/B	~HK\$0.8m gain
Disposal of Peach Garden investment	N	~55.0	~2.0x P/B	~HK\$30m gain
Disposal of China Gloria	N	~15.0	~1.5x P/B	~HK\$5.0m gain

Source: Company data, SBI E2-Capital

In position to beat HK\$150.0m for FY12/08F. With its current network of CD&T centres, we estimate that Renji is currently on pace to hit a net profit of around HK\$120-130m in FY12/08. This puts the company in a good position to beat the HK\$150.0m profit warranted in the original Anping Medical acquisition. We expect that the company to announce a further 5-8 acquisitions this year, thus giving us increased confidence in the company to beat the profit hurdle.

Estimates lifted. We have revised up our FY12/07F and FY12/08F estimates to take into consideration: 1) the 49% acquisition of Er Pao CD&T and 2) better than expected one-off gains from the non-core asset disposal. We now estimate the company's net profit at HK\$30.6m in FY12/07F and HK\$172.2m in FY12/08F (c.f. a net loss of HK\$6.0m in FY12/07F and HK\$160.5m in FY12/08F), assuming that the disposal gains will be booked in FY12/07F.

Re-iterate BUY call. The full consolidation of the Er Pao facility will allow Renji to fully capitalize on its growth prospects. Meanwhile, the likely reversal of the net loss will provide a clearer picture of the contribution from Anping Medical. We re-iterate our BUY call on Renji with a target price of HK\$0.45. Our DCF-derived target price represents 32.0x FY12/08F P/E on a fully diluted basis.

Table 4: P&L

Year to Dec (HK\$m)	05A	06A	07F	08F	09F
Turnover					
Investment holding	2.5	6.4	9.0	-	-
Financial services	29.1	59.2	71.8	-	-
Media, consulting, technology	20.1	2.8	0.1	-	-
Garment manufacturing	53.7	64.2	62.6	-	-
Property holding & others	7.1	7.9	8.1	-	-
Medical services	-	-	86.5	357.3	391.7
	112.4	140.2	238.2	357.3	391.7
Cost of sales	(62.9)	(74.8)	(105.2)	(146.7)	(156.9)
Gross profit	49.8	65.5	133.1	210.5	234.7
Other revenues	2.6	15.2	29.5	24.2	71.4
Distribution costs	-	-	-	-	(0.1)
Administrative expenses	(73.4)	(84.3)	(115.3)	(27.8)	(54.8)
Other operating income/(expenses)	9.1	1.5	(9.6)	(12.5)	(25.1)
Exceptionals	(42.4)	(18.2)	8.3	4.1	2.0
Operating profit	(54.6)	(20.3)	45.9	198.6	228.2
Finance costs	(4.2)	(6.3)	(8.9)	(6.7)	(6.4)
Share of results from associates	(33.6)	(54.7)	(1.0)	-	-
Profit before taxation	(92.4)	(81.3)	36.0	191.9	221.9
Taxation	(0.8)	(2.1)	(4.2)	(18.7)	(21.7)
Profit after tax	(93.2)	(83.4)	31.8	173.2	200.2
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	(93.6)	(83.0)	30.6	172.7	199.7
% chg	na	na	na	464.4	15.6
Dividends	-	-	-	-	-

Source: Company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the sole bookrunner and placing agent for the China Renji Medical Group Ltd (formerly known as Softbank Investment International (Strategic) Ltd) in April 2007.
An Executive Director of SBI E2-Capital Securities Ltd. is also an Executive Director of China Renji Medical Group Ltd.

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbi2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months
BUY : absolute upside of >10% over the next six months
HOLD : absolute return of -10% to +10% over the next six months
SELL : absolute downside of >10% over the next six months

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.