

China Renji



BUY (unchanged)

Deciphering the numbers

Key points:

- FY12/07A net profit of HK\$12.8m, with gains from non-core asset disposals offsetting deficit from impairment charges in 1H FY12/07.
- Medical network division meets guarantee.
- Solid patient growth – Er Pao Hospital CD&T centre's total patient number at 148 in Dec 2007, from 84 in July.
- Unexpected intangible asset amortization charges and unallocated corporate expenses will weigh down future earnings.
- New target price of HK\$0.20, representing 22.0x FY12/09F P/E.

Return to the black. China Renji (Renji) recorded a HK\$12.8m net profit in FY12/07A, reversing a 1H FY12/07A loss of HK\$39.8m. This implies that the company's 2H FY12/07A net profit was in the order of HK\$52.6m, which included several one-off items as expected. Gains from non-core asset disposals were enough to cover the impairment charge of HK\$42.6m recognized in 1H FY12/07A. More importantly, since the completion of the acquisition of Anping Medical (Anping) on 13 Jul 2007, the company has successfully disposed of essentially all of its non-core assets in a bid to focus on China's burgeoning healthcare sector.

Anping meets guarantee. Anping's adjusted segment profit came in at HK\$45.9m, implying an adjusted net profit of HK\$36.2m for 14 Jul- 31 Dec 2007. Including the HK\$39.5m net profit for the period of 1 Jan -13 Jul 2007, Anping's total net profit was HK\$75.7m, which meets the minimum guarantee of HK\$70.0m, as stipulated in the acquisition agreement. Anping's adjusted bottom line was slightly below our estimates, mainly due to the issue of tax expenses. The company had been reporting and paying tax at the rate of 3.3% of gross turnover. However, as it had not been able to obtain all necessary approvals, its auditor made a provision for tax expenses at the rate of 33% of pre-tax profit for 14 Jul- 31 Dec 2007. If tax expenses were taken at the actual reporting rate of 3.3% of gross turnover, the adjusted net profit for the 14 Jul - 31 Dec 2007 period would be HK\$44.7m, implying a pro-forma full-year net profit of HK\$84.2m, in line with our expectations.

Shanghai hospitals remain mainstays. The CD&T centres at 411 and 455 Military Hospitals in Shanghai were the main contributors in FY12/07A. For the proforma FY12/07A, revenue (excluding business tax) from 411 and 455 CD&T centres reached HK\$25.6m and HK\$47.0m, representing 23.7% and 43.5% of total, respectively. Subsequent acquisitions announced in 2H FY12/07A also contributed, with Er Pao, Hefei and Shenyang CD&T centres together accounting for 7.4% of medical service revenue. The contribution revenue from the three newly acquired CD&T centres was slightly below expectations. According to accounting standards, only the portion of revenue after the completion of the

China Healthcare

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Stock data

Price	HK\$0.087
Target price	HK\$0.20 (+130%)
12 mth range	HK\$0.074-0.335
Market cap.	US\$129.3m
Daily t/o, 3 mth	US\$0.41m
Free float %	70.5%
Ticker	0648.HK/648 HK

Financial summary

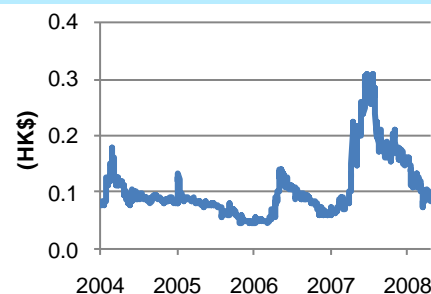
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	9.1	58.5	189.1	273.0	312.6
Net Profit (HK\$m)	(83.0)	12.8	34.0	100.8	133.0
EPS (HK\$m)	(0.018)	0.002	0.003	0.009	0.012
EPS Δ %	19.3	n/a	87.3	196.8	31.9
P/E (x)	n/a	54.1	29.2	9.8	7.5
P/B (x)	4.52	0.78	0.94	0.86	0.77
EV/EBITDA (x)	54.5	58.4	6.2	3.5	2.4
Yield (%)	-	-	-	-	-
ROE (%)	n/a	1.7	2.9	9.1	10.9
ROCE (%)	n/a	n/a	6.0	11.2	13.3
N. Gear. (%)	Cash	2.8	0.8	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(15.9)	(28.8)	(64.8)
Actual price changes (%)	2.4	(22.3)	(56.1)

	08F	09F	10F
Consensus EPS (HK\$)	0.014	0.016	-
Previous forecasts (HK\$m)	172.7	199.7	-
Previous EPS (HK\$)	0.014	0.016	-

Price Chart



respective acquisitions were recognized even though in the original acquisition agreement the vendor had warranted to allow Renji to recognize the revenues for the full 2H FY12/07.

Table 1: Contribution of CD&T centres

Year to Dec (HK\$m)	14 Jul-31 Dec	%	Proforma 07A	%	No. of Patients
Medical services revenues					
411 Hospital CD&T Centre	13.5	23.7	25.6	23.7	2,313
455 Hospital CD&T Centre	23.6	41.4	47.0	43.5	3,949
Er Pao Hospital CD&T Centre	3.6	6.3	3.6	3.3	763
Hefei Gamma Knife Centre	2.7	4.7	2.7	2.5	570
Shenyang 463 CD&T Centre	1.7	3.0	1.7	1.6	816
Shanghai Renji	6.0	10.5	9.9	9.1	n/a
Others	5.9	10.4	17.6	16.3	n/a
	57.0	100.0	108.1	100.0	

Er Pao, Hefei and Shenyang revenue contribution from date of completion of acquisition only.

Patient nos. for gamma knife treatment (head and body) only. Numbers for Hefei, Shenyang, Er Pao for 6 months

Source: Company data, SBI E2-Capital

Table 2: P&L of medical network division

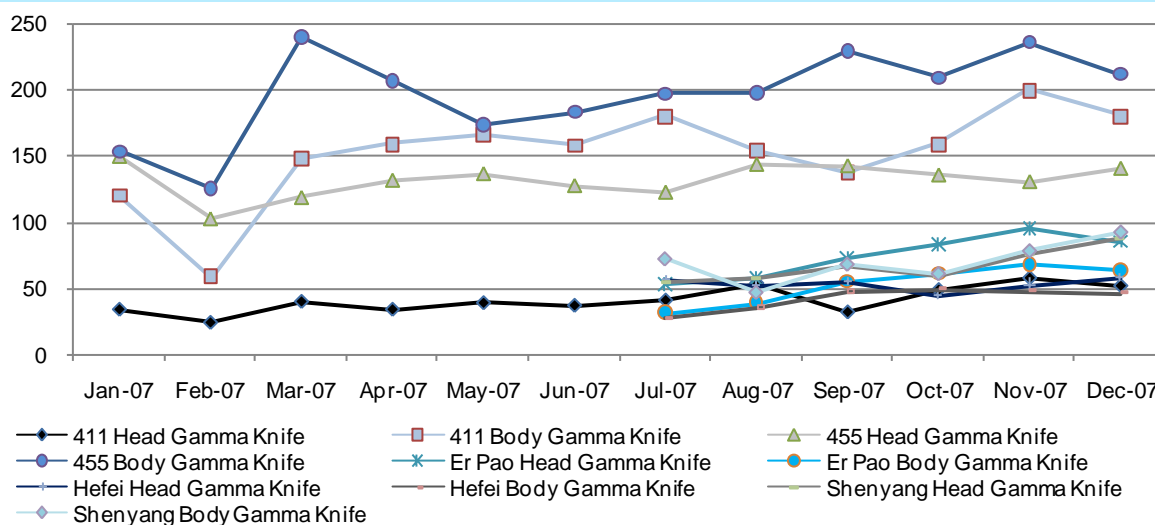
Year to Dec (HK\$m)	Proforma 07A	Remarks
Revenue	108.1	411, 455, Shanghai Renji, Hefei, Shenyang and Er Pao centres
Cost of services	(9.8)	
Gross profit	98.3	
Other income	2.1	
Negative goodwill	14.9	From restructuring of Anping group
Administrative expenses	(10.4)	
Profit before taxation	104.9	
Tax	(11.9)	Tax rate of 3.3% on gross t/o (1 Jan-13 Jul). Tax rate of 33% (Jul-31 Dec)
Profit before tax	93.0	
Minority interest	(2.4)	
Net profit	90.6	
Net profit (ex. one-off items)	75.7	Excluding negative good of HK\$14.9m
Net profit (proforma)	84.2	Reporting tax rate of 3.3% on gross turnover

Source: Company data, SBI E2-Capital

Steady patient growth. Patient flows at all CD&T centres are growing. The new CD&T centre at Er Pao has been particularly encouraging. The number of head gamma knife patients has ramped up from 53 in July to 85 in December 2007. The number of body gamma knife patients increased from 31 to 63 in the period. Management indicates that the total number of patients treated at the new centre (including PET-CT and Linear Accelerator Patients) reached around 300 in March 2008. In FY12/07, 411 CD&T centre treated 494 head gamma knife patients and 1,819 body gamma knife patients and 455 CD&T centre 1,587 head gamma knife patients and 2,362 body gamma knife patients. In our view, there is still capacity for growth given that 411 CD&T centre's equipment still appears underutilized. The management can rationalize the resources by diverting any excess patients between the centres.

Er Pao CD&T centre shows promising prospects. We believe that Renji's Er Pao CD&T centre can potentially be a promising growth driver for the company. Based on our channel checks, there are currently 8 sets of gamma knives in Beijing, of which only 6 are operational. Of the functioning 6 sets, 2 sets are owned by Renji. The limited supply of gamma knife equipment in Beijing (Shanghai has 12 sets) suggests that demand for Er Pao CD&T centre's services should be strong going forward.

Chart 1: Patient trends at CD&T centres



Source: Company data, SBI E2-Capital

Table 3: Renji acquisition summary (since completion of Anping Medical acquisition)

Project	Date announced	Date completed	Acquired stake (%)	Consideration	Attributable net income warranted
ErPao (Tranche 1)	Sep 2007	21/09/07	51.0	RMB74.12m (cash + new shares)	RMB10.2m (FY12/08)
ErPao (Tranche 2)	Jan 2008	25/02/08	49.0	RMB71.22m (cash + new shares)	RMB9.8m (FY12/08)
Hefei	Oct 2007	11/10/07	100.0	RMB46.2m (cash)	RMB5.0m (FY12/07) RMB12.0m (FY12/08)
Shenyang	Nov 2007	09/11/07	100.0	RMB41.0m (cash)	RMB10.0m (07/07-06/08) RMB10.0m (07/08-06/09)

Source: Company data, SBI E2-Capital

Amortisation of intangible asset - negative surprise. The booking of a HK\$26.9m amortization charge relating to the Anping acquisition was a negative surprise. The intangible asset of HK\$359.4m relates to lease and consultancy contracts, which would be amortised over the life of the contracts. The company said it would approach the respective hospitals to review the terms/nature of the contracts to minimize the impact of the amortization charge. We would welcome this since, although a non-cash expense, the charge weighs down the P&L.

Solid cash flow obscured by non-cash items. Medical services generated an operating cash flow of HK\$47.9m, up from HK\$15.9m a year ago, with Anping contributing the bulk. Unfortunately, this cash generating ability was somewhat lost amongst the non-cash items in the P&L, such as stock option expenses (HK\$17.4m), amortised costs of the promissory notes included in the finance costs (HK\$17.8m) and impairment losses on available-for-sale-investments (HK\$15.6m). At end-FY12/07A, HK\$200.0m of the note had been redeemed. According to the management, only around HK\$50.0m of the original HK\$320.0m note remains. Excluding these non-cash expenses, adjusted net loss amounted to HK\$1.1m in FY12/07A.

China healthcare focus. During the second half of the year, and subsequent to the year-end, Renji disposed of essentially all of its non-core assets and businesses transforming itself into a focused China healthcare play. Profit from discontinued operations totaled HK\$93.7m, up 440.7% YoY, due to the disposal of the Foshan Country Club, which yielded a disposal gain of HK\$73.7m. At end-FY12/07A, Renji's only non-core asset was its investment holdings with a carrying asset value of HK\$2.1m.

Table 4: Breakdown of non-cash items

Item	HK\$m	Remarks
Continuing operations		
Impairment loss on avail'-for-sale investments	(15.6)	Impairment of investment bond
Change in fair value of financial assets	3.0	Revaluation of 8.6m shares of Winbox (474 HK)
Loss on disposal of subsidiaries	(5.9)	Disposal of 3 investment holding subsidiaries
Net gain on disposal of associates	9.8	Disposal of China Gloria, iMediaHouse and others
Loss on disposal of avail'-for-sale investments	(5.0)	Disposal of investment bond
Stock option expenses	(17.4)	
Amortisation of intangible assets	(26.9)	
Finance costs	(17.8)	Early redemption of promissory notes from Anping acq'
Sub-total	(75.8)	
Discontinued operations		
Gain on disposal of country club operations	73.7	
Loss on disposal of garment manu' operations	(6.5)	
Gain on disposal of property hldgs and others	6.4	
Impairment on assets classified as held for sale	(7.6)	
Subtotal	66.0	

Source: Company data, SBI E2-Capital

Expansion strategies in 2008. In FY12/08, Renji has a three pronged strategy to expand its business. This includes: 1) improving operations at CD&T centres acquired in 2H FY12/07A; 2) acquisition of CD&T centres and 3) acquiring stakes in hospitals to set up new CD&T centres within them. In terms of operating improvements, the company's plan is to migrate its management and operation best practices to the Er Pao, Hefei and Shenyang CD&T centres and they have already relocated the centre manager from the 455 CD&T centre in Shanghai to run the Er Pao operations. Meanwhile, we also expect the Renji to install one more set of gamma knife at 455 centre and take over the management of 2 sets of gamma knives at Shanghai Renji Hospital. The knives at Shanghai Renji are in the process of obtaining the necessary license approvals.

Adjustments in Anping's earnings model. Given the unexpected items such as the intangible asset amortization and higher-than-expected tax rate, we have adjusted our earnings model. We have now incorporated amortization costs of HK\$54.0m per year and an effective tax rate of 18.0%. We note that some unallocated corporate expenses remain and will add them into the model. We now expect Anping to record a net profit of HK\$129.7m in FY12/08F, HK\$187.2m in FY12/09F and HK\$222.0m in FY12/10F, before the incorporation of amortisation charges, finance costs and unallocated corporate expenses.

Table 5: Revenue breakdown

Year to Dec (HK\$m)	08F	09F	10F	Remarks
Medical services revenues				
411 Hospital CD&T Centre	29.5	31.8	33.6	
455 Hospital CD&T Centre	51.8	52.6	52.8	
Er Pao Hospital CD&T Centre	23.0	33.5	41.6	
Hefei Gamma Knife Centre	15.4	17.8	19.6	
Shenyang 463 CD&T Centre	16.7	20.1	23.1	
Shanghai Renji	10.4	10.7	11.0	
Newly acquired centres	25.0	76.8	109.2	3 new centres in 2008 and 4 in 2009
Others	20.4	38.6	44.1	Minority stakes in 3 hospitals in 2009
	192.3	281.8	335.0	

Source: SBI E2-Capital

Table 6: China Renji P&L

Year to Dec (HK\$m)	08F	09F	10F	Remarks
Medical services	189.1	273.0	312.6	
Cost of sales	(69.9)	(76.8)	(78.5)	
Gross profit	119.2	196.2	234.0	
Other revenues	5.6	6.1	6.7	
Distribution expenses	-	-	-	
Administrative expenses	(37.7)	(38.9)	(40.1)	
Finance costs	(16.8)	(14.6)	(12.2)	
Share of results from associates	-	-	-	
Profit before tax	70.3	148.8	188.5	
Tax	(33.0)	(42.9)	(49.6)	
Profit after tax	37.4	105.9	138.8	
Minority interest	(3.4)	(5.0)	(5.8)	
Net profit	34.0	100.8	133.0	

Source: SBI E2-Capital

Table 7: Proforma net profit (for illustrative purposes only)

Year to Dec (HK\$m)	08F	09F	10F	Remarks
Net profit	34.0	100.8	133.0	
Net profit (proforma 1)	88.0	154.8	187.0	Ex. Intangible asset amort'
Net profit (proforma 2)	128.4	190.4	220.3	Ex. Intangible asset amort', corporate, finance exp

Source: SBI E2-Capital

New target price at HK\$0.20, maintain BUY. We remain upbeat about Renji's long term prospects due to its: 1) exposure to China's healthcare industry; 2) positioning in specialist healthcare services and 3) scalable business model, with a combination of M&A and organic growth strategies. That said, we note the market's current reduced risk appetite and have therefore reset our target price to HK\$0.20, representing 22.0x FY12/09F P/E.

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.

P & L (HK\$m)	06A	07A	08F	09F	10F	Cash Flow (HK\$m)	06A	07A	08F	09F	10F
Year to Dec						Year to Dec					
Turnover	9.1	58.5	189.1	273.0	312.6	EBIT	(18.5)	(32.5)	87.1	163.4	199.6
% chg	(91.9)	541.8	223.5	44.4	14.5	Depre./amort.	34.3	49.7	74.5	76.9	78.1
Gross profit	8.2	24.6	119.2	196.2	234.0	Net int. paid	(3.9)	(2.7)	(11.2)	(14.6)	(12.2)
						Tax paid	-	(0.9)	(5.7)	(8.2)	(9.4)
EBITDA	15.8	17.2	161.6	240.3	277.7	Dividends received	(17.5)	(1.4)	-	-	-
Depre./amort.	(34.3)	(49.7)	(74.5)	(76.9)	(78.1)	Gross cashflow	(5.7)	12.2	144.7	217.5	256.2
EBIT	(18.5)	(32.5)	87.1	163.4	199.6						
Net int. income/(exp.)	(3.9)	(26.6)	(16.8)	(14.6)	(12.2)	Chgs. in working cap.	21.6	(150.1)	55.3	53.2	(9.8)
Exceptionals	(23.7)	(15.6)	-	-	-	Operating cashflow	15.9	(137.9)	200.0	270.6	246.3
Associates	(54.7)	(0.7)	-	-	-						
Jointly-controlled entit.	-	-	-	-	1.0	Capex	(2.4)	(206.0)	(180.0)	(150.0)	(120.0)
Pre-tax profit	(100.8)	(75.4)	70.3	148.8	188.5	Free cashflow	13.5	(343.9)	20.0	120.6	126.3
Tax	-	(1.5)	(33.0)	(42.9)	(49.6)						
Minority interests	0.4	(4.0)	(3.4)	(5.0)	(5.8)	Dividends paid	-	-	-	-	-
Net profit	(83.0)	12.8	34.0	100.8	133.0	Net distribution to MI	(0.4)	0.4	(4.0)	(3.4)	(5.0)
% chg	(11.3)	n/a	165.2	196.8	31.9	Investments	(70.8)	(220.6)	-	-	-
						Disposals	22.0	145.2	-	-	-
Dividends	-	-	-	-	-	New shares	51.5	250.0	-	-	-
Retained earnings	(83.0)	12.8	34.0	100.8	133.0	Others	(1.7)	27.6	(4.0)	53.1	54.8
						Net cashflow	14.2	(141.3)	12.0	170.3	176.1
EPS (HK\$) - Basic	(0.018)	0.002	0.003	0.009	0.012						
EPS (HK\$) - F.D.	(0.017)	0.002	0.003	0.009	0.012	Net (debt)/cash - Beg.	106.1	120.3	(21.0)	(8.9)	161.4
DPS (HK\$)	-	-	-	-	-	Net (debt)/cash - End.	120.3	(21.0)	(8.9)	161.4	337.4
No. sh.s o/s (m) - W.A.	4,731.9	8,053.8	11,402.3	11,402.3	11,402.3						
No. sh.s o/s (m) - Y.E.	4,976.3	11,402.3	11,402.3	11,402.3	11,402.3						
No. sh.s o/s (m) - F.D.	4,731.9	8,480.4	11,402.3	11,402.3	11,402.3						
						Interim Results (HK\$m)	05A	06A	07A		
Margins (%)						Six months to Jun					
Gross	89.6	42.1	63.0	71.9	74.9	Turnover	51.1	75.5	96.3		
EBITDA	173.3	29.3	85.5	88.0	88.8	% chg	2.4	47.6	27.6		
EBIT	(202.9)	(55.6)	46.1	59.9	63.9	Profit from operations	(18.7)	(5.1)	(31.8)		
Pre-tax	(1,106.6)	(129.0)	37.2	54.5	60.3	Interest expenses	(1.8)	(3.0)	(4.7)		
Net	(911.8)	21.9	18.0	36.9	42.5	Associates	(14.7)	(2.8)	(0.1)		
						Jointly-controlled entit.	-	-	-		
Balance Sheet (HK\$m)	06A	07A	08F	09F	10F	Pre-tax profit	(35.2)	(10.9)	(36.5)		
Year to Dec						Tax	(0.3)	(2.4)	(1.5)		
Fixed assets	115.0	242.3	347.8	420.9	462.9	Minority interests	0.1	(0.2)	(1.9)		
Intangible assets	-	911.4	857.4	803.4	749.4	Net profit	(35.3)	(13.5)	(39.8)		
Other LT assets	24.8	-	-	-	-	% chg	n/a	(61.7)	(194.8)		
Cash	210.4	170.3	346.7	441.6	548.6						
Accounts receivable	53.4	11.3	25.0	30.0	33.0	EPS (HK\$) - Basic	(0.008)	(0.003)	(0.760)		
Other receivables	47.6	153.6	80.0	20.0	26.0	DPS (HK\$)	-	-	-		
Inventories	10.6	-	-	-	-						
Due from related co.s	-	-	-	-	-	Shareholding Structure					
Other current assets	-	175.9	-	-	1.0						
Total assets	461.8	1,664.8	1,656.9	1,715.9	1,820.9						
Accounts payable	(45.1)	-	-	-	-						
Other payable	(74.8)	(23.1)	(18.5)	(16.6)	(15.8)						
Tax payable	(0.7)	(18.8)	(45.5)	(79.4)	(118.7)						
Due to related co.s	-	-	-	-	-						
ST debts	(4.0)	(78.3)	(62.6)	(75.1)	(67.6)						
Other current liab.	-	(73.7)	(70.0)	(66.5)	(63.2)						
LT debts	(86.1)	(113.0)	(293.0)	(205.1)	(143.6)						
Other LT liabilities	(1.8)	(83.1)	(83.1)	(83.1)	(83.1)						
Total liabilities	(212.5)	(389.9)	(572.7)	(525.9)	(492.0)						
Share capital	497.6	1,140.2	912.2	912.2	912.2						
Reserves	(280.5)	111.3	145.2	246.1	379.1						
Shareholders' funds	217.1	1,251.5	1,057.4	1,158.3	1,291.2						
Minority interest	32.2	23.4	26.8	31.8	37.6						
Total	249.4	1,274.9	1,084.2	1,190.1	1,328.9						
Capital employed	339.4	1,466.1	1,439.8	1,470.3	1,540.1						
Net (debt)/cash	120.3	(21.0)	(8.9)	161.4	337.4						
						Key Ratios	06A	07A	08F	09F	10F
						Net gearing (%)	Cash	2.8	0.8	Cash	Cash
						Net ROE (%)	na	1.7	2.9	9.1	10.9
						EBIT ROCE (%)	na	(3.6)	6.0	11.2	13.3
						Dividend payout (%)	-	-	-	-	-
						Effective tax rate (%)	na	na	46.9	28.8	26.3
						Net interest coverage (x)	na	na	5.2	11.2	16.4
						A/R turnover (days)	2,175.9	201.8	35.0	36.8	36.8
						A/P turnover (days)	1,858.8	140.8	-	-	-
						Stock turnover (days)	3,601.4	57.4	-	-	-

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