Corporate Flash

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SIIS: China healthcare play with an edge

Recommendation: BUY (initiating coverage) | **Hong Kong Conglomerates**

Price	**HK$0.235**
Target price	HK$0.40 (+70%)
12 mth range	HK$0.057-0.280
Market cap.	US$171.3m
Daily t/o, 3 mth	US$12.4m
Free float %	86.3%
Ticker	0648.HK/648 HK

Year to Dec	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gear. %
05A	(93.6)	(0.022)	n/a	n/a	12.2	n/a	-	n/a	n/a	Cash
06A	(83.0)	(0.018)	(19.3)	n/a	10.5	534.0	-	n/a	n/a	Cash
07F	52.3	0.008	(143.0)	31.2	2.4	13.2	-	8.9	9.6	Cash
08F	166.6	0.014	87.1	16.7	2.6	6.1	-	18.1	15.9	Cash
09F	191.8	0.016	15.1	14.5	2.1	4.8	-	19.6	18.5	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +8.4%, +2.2%, +184.1%
Actual price changes (1 mth, 3 mth, 12 mth): +5.0%, +1.6%, +201.2%

Key points:

- SIIS' planned acquisition of the operator of cancer diagnosis and treatment (CD&T) centers, China Renji, places the company at the forefront of China's healthcare sector, one of the most lucrative emerging services on the mainland.
- The acquisition (amounting to HK$641.0m in cash, shares and bonds) is investor friendly, with minimal initial cash outlay, one-time share dilution and appropriate valuation adjustments based on future earnings targets.
- Cancer is the no. 1 cause of death in China, with a morality rate of 144.6/100,000 in urban areas in 2006, the highest rate amongst the world's top 10 health expenditure countries.
- Renji's frontline healthcheck services act as a driver for the business, funneling additional cancer patients into Renji's treatment centres.
- Chinese culture is health conscious. With rising disposable incomes and proliferation of health insurance, we expect demand for healthcare services in China to surge.
- Renji's hospital acquisition model of setting up CD&T centres is far better than outright acquisitions as it can widen the range of treatments offered, increase patient catchment area and in-patient flow, and increase demand for regular hospital services.
- We believe SIIS' acquisition of Renji is the most prudent among the recent forays into healthcare by listed companies due to its sensible acquisition valuation, multi-year profit guarantees and exit clauses, the company's extensive network and scalable business model.
- Initiate coverage with target price of HK$0.40, representing 28.5x FY12/08F P/E. The valuation is at a pragmatic discount to 41.5x traded by comparable China healthcare plays and 30.4x traded by peers in other emerging countries such as India. The counter is currently trading at an undemanding 16.7x FY12/08F P/E.

Renji allows SIIS to capture China's healthcare sector. SIIS' 30 Apr 2007 announcement of its acquisition of China Renji (Renji) heralds the diversification of the Hong Kong conglomerate into China's lucrative healthcare sector. The HK$641.0m deal (in cash, shares and bonds) is subject to adjustments and represents 8.0x (9.2x) FY12/07 and 4.3x FY12/08 P/E based on net profit guarantees of HK$80.0m (HK$70.0m minimum) for FY12/07 and HK$150.0m for FY12/08 provided by Renji. Renji is an investment holding company whose sole asset is Anping Medical, a China-based manager and operator of medical centres, specializing in the diagnosis and treatment of tumours/cancers in cooperation with renowned hospitals.

Table 1: Consideration breakdown

Item	HK$m
Cash	50.0
2,710m shares at issue price of HK$0.10 each (49.5% discount to the last trading price of HK$0.198)	271.0
Issue of three-year bonds (coupon rate of 3% p.a. payable semi-annually)	320.0
Total	641.0

Source: SBI E2-Capital

Renji's management to become largest shareholder. On completion of the acquisition, Renji's management will become SIIS' largest shareholder with a 22.93% stake, assuming the placing option, all outstanding share options and convertible bonds are exercised in full. Renji will have a right to nominate three executive directors to the board, with one of them nominated as co-chairman.

Name change to "China Renji". On 29 May the company announced the listco's name would be changed from "Softbank Investment International (Strategic) Ltd." to "China Renji Medical Group Ltd." subject to the completion of the acquisition and approval by shareholders at the EGM. The name change will benefit the company, as it will better reflect its core business.

Additional placing agreement. SIIS has also entered into an agreement to place 1,500m new placing shares (with an option to place an additional 500m placing shares) to not less than six investors. The placing price of HK$0.125 each represents a discount of 36.9% to the last trading price of HK$0.198. The net proceeds of about HK$177.5m (placing option not exercised) or HK$237.5m (placing option exercised in full) will be used to expand Renji's medical treatment business including: 1) purchase of medical equipment for diagnosis and treatment of tumours/cancers; 2) setting up new tumour/cancer diagnosis and treatment (CD&T) centres and 3) acquisition of hospitals in China.

Investor friendly deal structure, with limited downside risk. In our view, the Renji deal is investor friendly, posing limited downside risk for SIIS listco because: 1) the initial cash outlay of HK$50.0m is not substantial; 2) Renji management becomes the largest shareholder in SIIS on completion of the deal and will nominate new executive directors to the board; 3) Renji management provides profit guarantees for FY12/07 and FY12/08 to provide investors with a valuation benchmark; 4) the deal provides prudent mechanisms for valuation adjustment in case profit guarantees are not reached in both years (the deal incorporates an exit clause for SIIS in the event that Renji's FY12/07 net profit is below HK$40.0m) and 5) dilution of listco shares is one off. Bonds issued to Renji are not convertible into shares and the company may redeem them early without any premium/discount.

Table 2: Prudent acquisition structure

Item	Remarks
Prudent initial cash outlay by listco	❑ Though overall acquisition consideration is HK$641.0m, initial cash outlay is only HK$50.0m
Appropriate Renji representation on SIIS Board	❑ Renji management may nominate three new executive directors to the board, including one as co-chairman
Profit guarantee and valuation adjustment	❑ Renji deal offers profit guarantees, with mechanisms to adjust acquisition consideration if targets are not reached
	❑ Exit clause for SIIS if FY12/07 net profit is less than HK$40.0m
Bonds do not further dilute share structure	❑ Bonds are not convertible into shares, ensuring that share dilution from the Renji acquisition is one-off.
	❑ SIIS can early redeem bonds without premium/discount

Source: SBI E2-Capital

Table 3: Fully diluted share calculation after acquisition

	At date of announcement		On completion of acquisition	
	No. of shares (m)	%	No. of shares (m)	%
Directors	15.1	0.3	334.8*	2.8
Placees	-	-	2,000.0	17.1
Vendor	-	-	2,710.0	22.9
Public	5,011.5	99.7	6,763.4**	57.1
Total	**5,026.6**	**100.0**	**11,808.2**	**100.0**

* *Assumes the full exercise of 319.8m share options held by the directors*

** *Assumes the full exercise of 711.5m share options and the full conversion of convertible notes amounting to 1,080.5m shares*

Source: Company data and SBI E2-Capital

Profit guarantee and acquisition valuation. Renji has provided a net profit guarantee (after tax, extraordinary/exceptional items and MI) of HK$80.0m for FY12/07 and HK$150.0m for FY12/08. This translates to an acquisition valuation of 8.0x FY12/07 P/E and 4.3x FY12/08 P/E. However, we note that the acquisition is not expected to be completed until around end-Jul 2007, implying that only around five months of Renji's FY12/07 net profit will be consolidated into SIIS' FY12/07 P&L.

Table 4: Profit guarantee and valuation adjustment

Condition		Valuation adjustment
FY12/07:	no less than HK$80.0m	❑ Profit guarantee achieved, no valuation adjustment
FY12/08:	no less than HK$150.0m	
FY12/07:	less than HK$70.0m	❑ Valuation adjustment: 7.0 x (HK$70.0 – actual FY12/07 profit) ❑ Vendor to pay company "valuation adjustment" in the form of: 1) cash payment; 2) forfeiting the amount in consideration shares which have been charged in favour of the company; 3) canceling the amount in outstanding bonds; 4) any combination of items 1) to 3)
FY12/07:	less than HK$40.0m	❑ SIIS has right to dispose of the entire share capital of China Renji ❑ China Renji will forfeit all the consideration shares, repay the cash consideration (HK$50.0m) and surrender the then outstanding portion of the bonds to SIIS at nil consideration
FY12/08:	less than HK$150.0m	❑ Valuation adjustment: 3.5 x (HK$1,500 – actual FY12/08 profit) ❑ Vendor to pay company "valuation adjustment" in the form of: 1) cash; 2) forfeiting the amount in consideration shares which have been charged in favour of the company; 3) canceling the amount in outstanding bonds; 4) any combination of items 1) to 3)

Source: Company data

First mover advantage in cancer diagnosis and treatment in China. Renji operates and manages a network of medical centres focusing on the treatment of tumours/cancers. The company has specialty experience in the use of the head/body gamma knife, linear accelerators and PET-CT for diagnosis and treatment. It has increased the number of its centers from two in 2006 to five currently. Renji currently has around 220 full-time employees, with 20+ full time specialists.

Cancer is no. 1 cause of death in China. According to the Ministry of Health, cancer is the no. 1 cause of death in China. In 2006, the per capita morbidity rate in rural areas was 130.2 per 100,000 (25.1% of deaths in China) and in urban areas 144.6 per 100,000 (27.3% of deaths). The national average of this figure increased from 36.9/100,000 in 1957 to 126.4/100,000 in 2004. According to the WHO's 2006 statistics, China had the highest per capita cancer mortality rate among the world's top 10 healthcare expenditure nations after adjustment for age standardization. Despite the increase in the cancer mortality rate, the percentage of beds in tumour departments fell from 14.4% of the total in 2000 to 13.7% in 2006.

Table 5: Top 10 causes of death in China (2006)

Cause of death	Rural areas		City areas	
	Rate	%	Rate	%
Cancer	**130.2**	**25.1**	**144.6**	**27.3**
Cerebrovascular diseases	105.5	20.4	93.7	17.7
Heart diseases	71.8	13.9	90.7	17.1
Respiratory diseases	84.9	16.4	69.3	13.1
Accidents, injuries and poisoning	46.1	8.9	32.4	6.1
Digestive diseases	17.0	3.3	15.6	2.9
Endocrine, immune system diseases	8.2	1.6	17.6	3.3
Genitourinary diseases	6.7	1.3	7.3	1.4
Nerve system diseases	4.2	0.8	5.0	0.9
Mental health diseases	3.8	0.7	3.4	0.7
Total for top 10 causes of death		92.3		90.4

Mortality rate is 1/100,000 population

Source: MOH

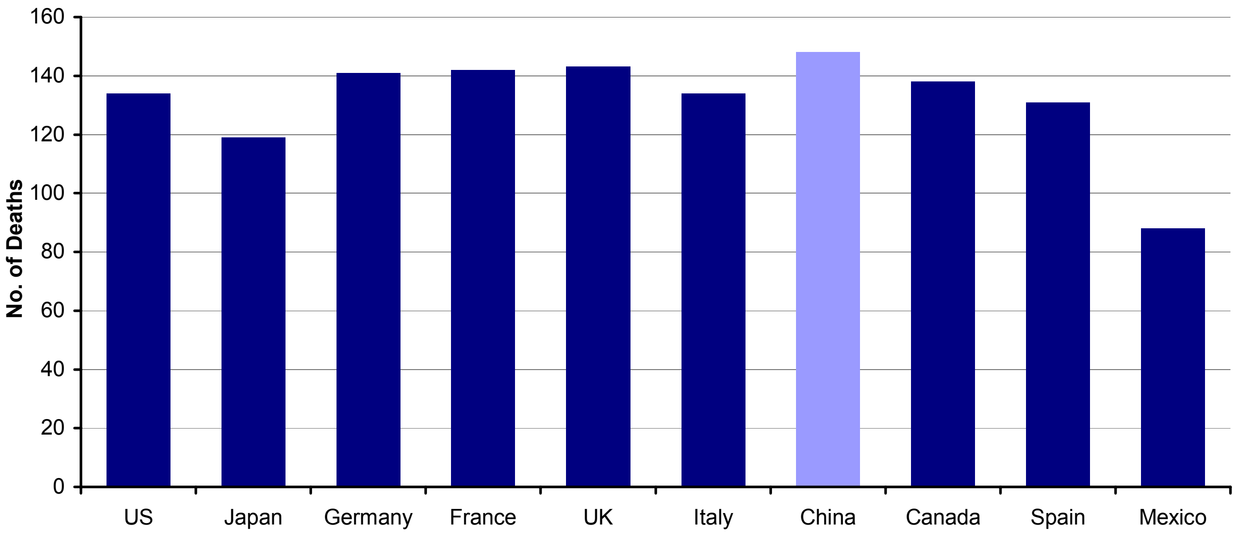
Table 6: Top 10 causes of death in China (1957-2004)

Cause of death	1957	Cause of death	1975	Cause of death	2004
Respiratory	120.3	Cerebrovascular	127.9	**Cancer**	**126.4**
Infectious	56.6	Heart related	115.3	Cerebraovascular	100.9
Pulmonary tuberculosis	54.6	**Cancer**	**111.5**	Heart related	99.4
Digestive	52.1	Respiratory	63.6	Respiratory	69.3
Heart related	47.2	Digestive	28.8	Accidents, injury, poisoning	31.1
Cerebrovascular	39.0	Pulmonary tuberculosis	21.2	Digestive	17.1
Cancer	**36.9**	Accidents, injury	16.8	Endocrine, immune	14.9
Nerve system	29.1	Infectious diseases	13.2	Genitourinary	9.5
Accidents, injury, poisoning	19.0	Genitourinary	11.6	Mental health	4.6
Tuberculosis	14.1	Poisoning	6.3	Nerve system	1.7

Mortality rate is 1/100,000 population

Source: MOH, china Health Statistical Yearbook, 1985, 2005

Chart 1: Age standardised cancer mortality rate for top 10 health expenditure nations (2002)



Source: WHO World Health Statistics 2006

Gamma knife ideal for cancer treatment in China. The gamma knife, invented by Swedish neurosurgeon Lars Leksell in 1967, is the most widely known stereostactic radiosurgery system. It uses beams of gamma radiation and is most effective in treating tumours less that 30mm in size. The small wavelength of gamma beams and the mode of application allow it to achieve extreme accuracies of greater than 1mm, with minimal effect on surrounding healthy tissue. The gamma knife is often employed for treatment of brain tumours. The mode of treatment maximizes patient comfort, unlike open surgery, which require incisions, or chemotherapy, which tends to have heavy side effects. It also offers relatively fast treatment (15-30mins). Head gamma treatments typically require up to two courses and body gamma treatments six to eight. With China's scarce medical facilities (especially specialized ones) and a high incidence of cancer, this allows quick turnaround of patients with a high success rate. The machine is robust, which is advantageous, given the limited government funding for Chinese hospitals. The first gamma knife machine in China was set up in the late 1960s and is still operational today. The machine costs around RMB12.0m to buy and install.

Table 7: Gamma knife advantages

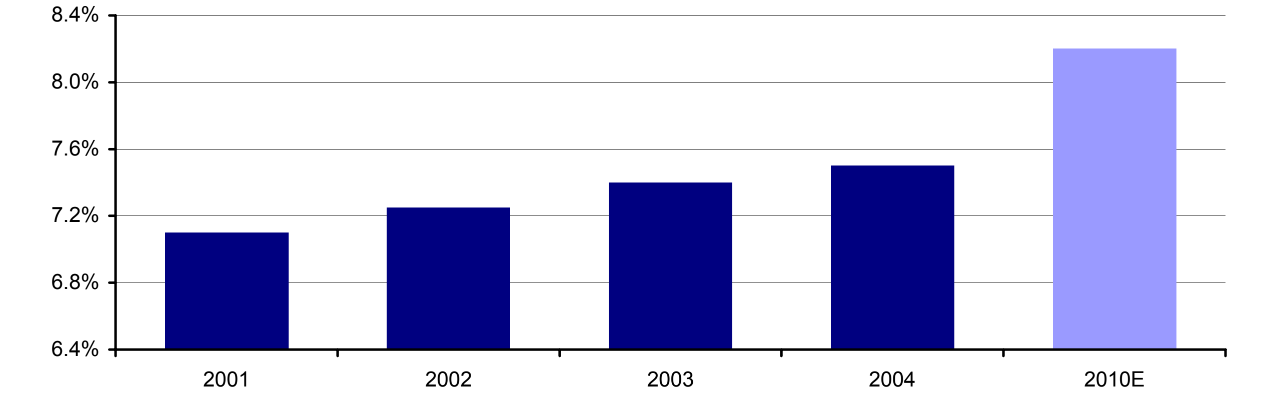
Advantages

- ❑ Treats cancerous tumours at an earlier stage, leading to higher chance of success
- ❑ No incision, no scars, no risk of haemorrhage or infection
- ❑ Treatment is painless and in most casts, requires no general anaesthetics
- ❑ Fast treatment time, high patient turnaround
- ❑ High accuracy, target rays reach only the tumor, not surrounding healthy tissue
- ❑ Can be used for inoperable tumours, vascular malformations, treatment of facial pain, focal epilepsy and Parkinson's disease

Source: Company data and SBI E2-Capital

Aging population. China's population is aging rapidly. The number of people aged 65+ is expected to increase to around 8.2% by 2010 from 7.5% in 2004. This trend will result in an increase of the incidence of potentially terminal illnesses, such as cancer and tumours, and fuel demand for specialized healthcare services such as those offered by China Renji.

Chart 2: China's aging population trend



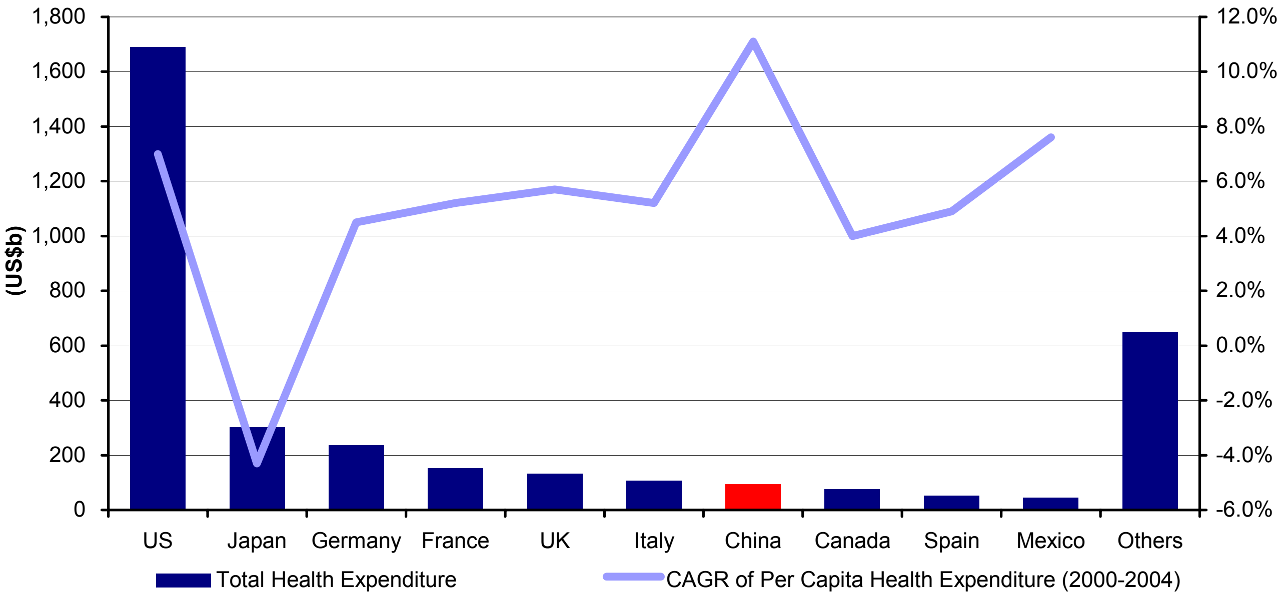
Source: Economic Intelligence

Lowest per capita healthcare expenditure. With the world's largest population and all domestic macro indicators pointing to an increasing demand trend for healthcare services, China's overall healthcare expenditure of US94.3b in 2004 was the seventh largest in the world. Its per capita healthcare spending of US$73 was the lowest among the top 10 health expenditure countries in 2004 (US: US$5.941, Japan: US$2,369, Mexico: US$433). On the positive side, its per capita expenditure CAGR of 11.1% in 2000-2004 was the highest.

Significant boost during 11th Five-year Plan. The Chinese government announced a series of initiatives to reform the healthcare sector in its 11th Five-year Plan, including: 1) encouraging private sector participation in healthcare; 2) allowing foreign investors to own up to 70% in Chinese-foreign JV hospitals; 3) extending the cooperative medical programme to 80% of the country's rural areas by 2011 and 4) continuing to regulate drug prices and tendering practices to reduce corruption and over-prescription. According to informal estimates, only around 10% of China's level 1-3 hospitals and around 5% of all hospitals have some level of private sector participation.

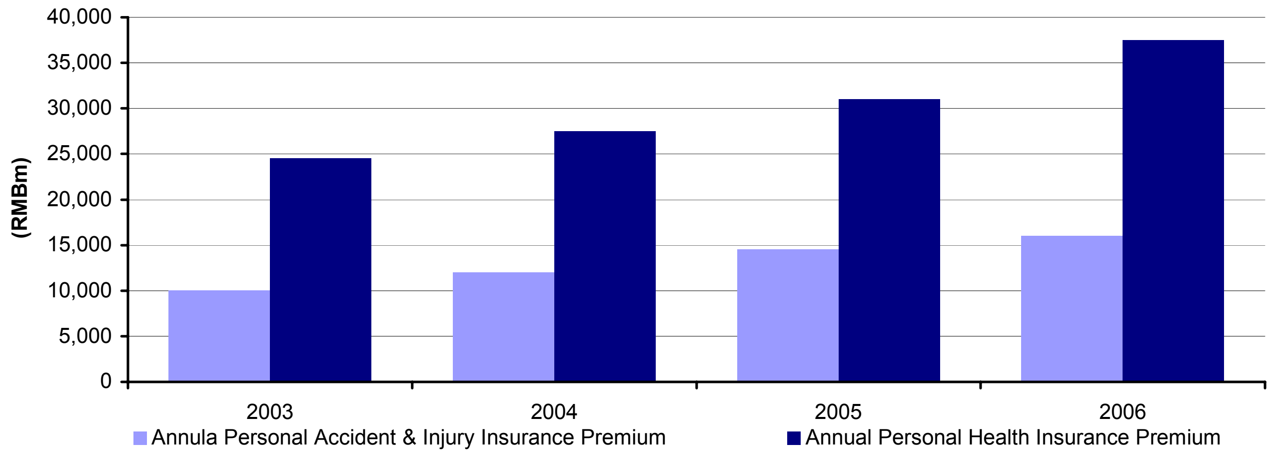
Health conscious culture to spur the development of health insurance. We expect demand for healthcare services, preventative or reactive, to grow significantly over the next few years. Chinese people are naturally health conscious and traditionally willing to spend money on health. This coupled with rising disposable incomes, aging population, growing healthcare preventative awareness and the government's encouragement to use private insurance plans as they become more affordable will fuel demand for medical services. On the supply side, insurance companies have traditionally focused on accident/injury insurance products as over-prescription by doctors meant that health insurance products were generally less profitable. However, with the governments' recent efforts to stamp out these practices, the profitability of personal health insurance products will increase, making them more attractive for insurance companies. According to the China Insurance Regulatory Commission, the nations' personal health insurance premiums grew at a three-year CAGR of 15.9% in 2003-2006.

Chart 3: World healthcare expenditure (2004)



Source: Euromonitor, WHO

Chart 4: China insurance premiums



Source: CIRC

Pricing controls to discourage over-prescription. The National Development and Reform Commission (NDRC) controls the pricing of drugs and medical services and we believe that price reductions will mainly be confined to drugs. Low doctor wages and low hospital profitability are the core problems of China's healthcare system, which frequently prompt doctors to over prescribe drugs. If the government stamps this out by lowering drug prices and increasing scrutiny, medical service fees should be kept relatively stable to enable hospitals to increase wage payments to resident doctors (while maintaining profitability). In 2006, the national average for in-patient medical expenses was RMB4,668.9, with examination and treatment fees representing only 26.0% and drug costs 42.3%. In MOH hospitals, the ratio is 26.7% and 39.5%.

Table 8: Breakdown of in-patient fees (2006)

	Overall average		MOH hospitals	
	RMB	%	RMB	%
Average medical expense for in-patient	4,668.9		12,434.2	
Drugs expenses	1,992.0	42.3	4,909.1	39.5
Examination and treatment expenses	1,211.8	26.0	3,322.1	26.7

Source: MOH

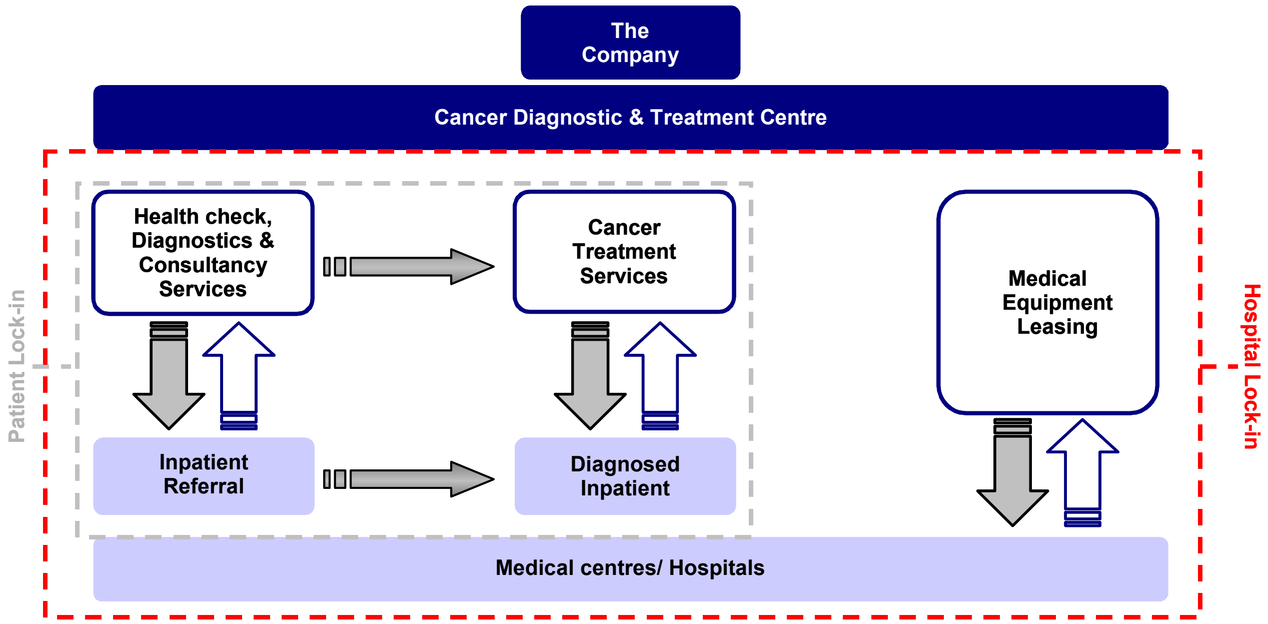
Vertically integrated model. Renji sets up its medical centres within renowned hospitals and operates a vertically integrated business model commencing with healthcheck services upstream, through to medical diagnosis, consultancy and treatment services. The centres are currently located in Shanghai (3), though they are currently finalizing agreements for other centres in Beijing, Jiangxi and Zhenzhou etc. This unique structure enables Renji to tie in patients and hospitals, integrating cancer diagnosis and treatment services into hospitals' operation process. By setting up CD&T centres, Renji can tap hospitals' vast client base directly. The hospital on the other hand, is reliant on Renji to treat its cancer patients. As a result, a value chain is developed and the hospital becomes dependent on Renji's expertise and specialized services.

Table 9: Renji's current facilities

Centre location	Facilities	Operation date	No. of beds at hospital	No. of beds managed by Renji	No. of patients in 2006
411 hospital	1 x head gamma knife	Extg	600	100	1.7m
Puxi (East)	2 x body gamma knife	Extg			
455 hospital	1 x head gamma knife	Extg	750	100	2.9m
Puxi (West)	2 x body gamma knife	Extg			
Shanghai Renji	1 x head gamma knife	June 2007	1,200	150	n/a
(Pudong)	1 x body gamma knife	June 2007			
	1 x linear accelerator	Extg			
	1 x PET-CT Scan	Extg			
	1 x CT Simulator	Extg			

Source: Company data

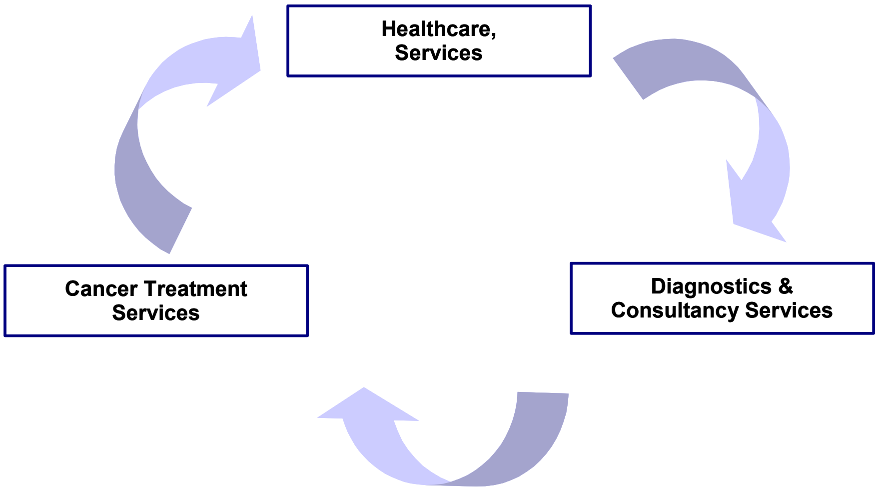
Chart 5: Vertically integrated business model



Source: Company data and SBI E2-Capital

Health check centre to increase lock-in effect, client base. Renji opened a new health check centre at the end of May 2007, as an extension of one of its existing CD&T center at Shanghai Renji Hospital. We expect healthcheck services to play an integral role in the company's overall business model. In our view, the healthcheck business is a low-risk, high-margin process which serves two purposes: 1) provides a stream of recurring income for Renji, which is expected to grow every year and 2) front-end services can double up as a screening operation and funnel additional cancer patients into Renji's CD&T centres. The addition of healthcheck services could extend the respective hospitals' client base with tailored offers to companies, comprising high-end packages for mid to top tier managers and low-end packages for general employees.

Chart 6: Healthcare business driving lock-in effect



Source: Company data and SBI E2-Capital

High-margin revenue model. Renji's revenue streams are three-fold, comprising: 1) equipment leasing; 2) management/medical consultancy and 3) hospital management fees. Under its hospital profit sharing model, Renji is entitled to 25% as equipment leasing fees and around 20% as management/medical consultancy fees (depending on the mode of treatment) of treatment fees from each cancer in-patient received by the hospital. Note that the revenue received from the hospital is net of all medical costs such as drugs, medical consumables, bed fees etc. and therefore, this cost structure allows Renji to command very high margins. Based on un-audited accounts in the announcement circular, Renji's FY12/06A net margin was 56.8%.

Hospital management - low risk operation. For Renji, hospital management is a low risk investment while allowing it to pinpoint future acquisition targets. The company typically receives 20% of the managed hospital's net profit. No upfront investment is required by Renji. By entering as a management trustee, Renji can first implement management reforms and gauge the hospital's future profitability, before considering whether or not to acquire it.

Fee structure of gamma knife treatment. The NDRC controls the pricing of gamma treatments. Hospitals receive RMB18,000 per course of head gamma knife treatments with a maximum cap of RMB30,000. For body gamma knife treatments, the initial course costs RMB20,000, and after that each course costs RMB2,000, up to a maximum of RMB35,000. In general, patients require one to two courses of head treatment and six to eight of body treatment. In body treatments, each tumour is considered a "separate" treatment unless they are very close to each other. According to the MOH, China had around 174 sets of head gamma knives in 2004, implying that only around 1% of hospitals have this facility. Shanghai currently has a total of 12 sets of gamma knife equipment, with eight belonging to Renji. The MOH controls the approval and establishment of gamma knife centers and Renji, with 67% of the Shanghai market, has a distinct advantage as the city, according to its management, is very strict with such licences. This also demonstrated Renji's close relationship with the MOH, which we believe should help it gain approvals/licences to set up CD&T centres in other cities.

CD&T centres boost demand for regular services. Renji is sought after by many hospitals as a cooperation partner because its CD&T centres can boost hospitals' catchment areas increasing their patient flow. This generates additional revenue and boost demand for hospitals' normal in-patient/out-patient services.

Three-tiered expansion plan. The company has a three-tiered expansion schedule comprising: 1) new equipment purchases; 2) new CD&T centres; 3) acquisitions of hospitals (around 70% stakes). Renji's typically seeks out top hospitals in second-tier cities, with: 1) 200+ hospital beds and around 400-500 out-patients daily; 2) net profit and 3) return period of 2.0-2.5 years. Renji deploys an innovative investment method. Rather than a straight up cash consideration, the company invests an agreed acquisition consideration in CD&T centres in return for a stake in the hospital. Including centres in Beijing, Jiangxi and Zhenzhou, Renji aims to set up seven new CD&T centres in FY12/07 and an additional four in FY12/08. We estimate its capex requirements at about RMB206.0m in FY12/07F and RMB103.0m in FY12/08F. Setting a CD&T centre takes around six months, including equipment ordering, fit out, equipment installation and commissioning. Therefore, we do not expect any significant contribution from the new CD&T centres to be set up in 2H FY12/07 until FY12/08.

Table 10: Renji's estimated capex requirements

Item		HK$m
2007		
Purchase of new equipment at existing centres		
two sets of gamma knife equipment		24.0
Establishment of new CD&T centres / hospital acquisitions		
Beijing (2), Zhenzhou, Anhui, Ningbo, Zhenjiang, Jiangxi		182.0
	2007 estimated capex	206.0
2008		
Purchase of new equipment at existing centres		
three sets of gamma knife equipment		36.0
Establishment of new CD&T centres / hospital acquisitions		
Jiangxi Renji, Zhenzhou, Guangdong, Hefei		67.0
	2008 estimated capex	103.0

Source: SBI E2-Capital

Cancer diagnosis and treatment model far superior than hospital acquisition. The government's move to open up the healthcare sector has prompted several hospital acquisitions by listed companies. We believe Renji's acquisition/investment model is far superior and potentially more profitable. In a straight up acquisition, the new management's strategy is typically limited to increasing the number of hospital beds and implementing management restructuring to improve profitability. However, it is important to note that increasing the number of beds may not lead to a substantial increase in in-patient flow. Renji's acquisition model of investing an agreed acquisition sum into a CD&T centre is able to significantly increase the hospital's top line by: 1) improving its comparative advantage by offering treatments not available in nearby hospitals; 2) increasing its patient catchment area and in-patient flow and 3) increasing demand for regular hospital services.

Renji - more solid acquisition among comparables. Among listed companies' recent deals to diversify into healthcare, SIIS' acquisition of Renji is the most prudent in our view and offers: 1) most prudent acquisition valuation; 2) multi-year profit guarantees and exit clauses; 3) most extensive network; 4) more scalable business model; 5) most specialized healthcare services and 6) most attractive current valuations. To compare, Hua Xia's acquisition of the St Edward Hospital in Chongqing is higher in terms of valuation, HK Healthcheck's series of health centres in Hong Kong is unlikely to break even in FY12/07, while Chun Wo's acquisition of Chengdu Friendship Hospital is based on appraised NAV equal to the acquisition consideration, with no profit guarantee (based on currently available details). Note that while SIIS' FY12/07F P/E valuation appears high, it only assumes a five-month contribution from Renji (assuming the deal is closed in July 2007).

Table 11: Local peer comparison

	SIIS	Hua Xia	HK Healthcheck	Chun Wo
Ticker	648 HK	8143 HK	397 HK	711 HK
Last Price	HK$0.235	HK$0.57	HK$0.470	HK$1.92
Description of service	Provision of healthchecks, cancer diagnosis and treatment services	Operation and management of hospital	Provision of healthcheck services in Hong Kong	Operation and management of hospital
Current extent of network	4 (Shanghai, Jiangxi)	1 (Chongqing)	1 (not including satellite centres)	1 (Chengdu)
Addressable market	China	China	Hong Kong	China
Acquired stake	100%	55%	Not through acquisition	100%
Acquisition consideration (HK$m)	641.0	157.3	n/a	49.7
Profit guarantee from acquisition	HK$80.0m (FY12/07F) HK$150.0m (FY12/08F)	HK$12.0m (FY3/08F) Nil (FY3/09F)	n/a	n/a
Acquisition valuation	9.2x (FY12/07) 4.3x (FY12/08)	13.1x (FY3/08)	n/a	Based on appraised NAV equal to consideration
Net profit	HK$52.3m (FY12/07F) HK$166.6m (FY12/08F)	HK$21.99m (FY3/08F) HK$34.53m (FY3/09F)	n/a	n/a
Fully diluted EPS	HK$0.008 (FY12/07F) HK$0.013 (FY12/08F)	HK$0.014 (FY3/08F) HK$0.022 (FY3/09F)	n/a	n/a
Estimated Fwd P/E	31.2x (FY12/07F) 16.7x (FY12/08F)	41.1x (FY3/08F) 26.4x (FY3/09F)	n/a	n/a

Source: Company data, Bloomberg and SBI E2-Capital

SIIS to gradually dispose of current business segments. At a recent analyst meeting, SIIS has indicated that once the Renji acquisition is completed, the company will dispose of its current business segments, though no timetable was given. These include technology, property holdings, garment manufacturing and financial services. Once this is completed, SIIS will be in a position to fully reflect its valuation as a pure China healthcare services play. Management has indicated that the proceeds will be re-injected into the Renji business. We have assumed in our model that the financial services business will be disposed of at a consideration of 1.3x P/B while the technology and garment businesses will each be disposed of at 1.0x P/B.

FY12/07F and FY12/08F estimates. We expect SIIS' FY12/07F net profit to come in at HK$52.3m off a turnover of HK$249.6m, including a five-month net profit contribution from Renji (if the acquisition is completed in Jul 2007) to a tune of HK$29.3m. In FY12/08F, with a full-year contribution from Renji, we project net profit to surge to HK$166.6m, with Renji accounting for HK$146.7m and gain adjustment for the disposal of the financial services. Our FY12/08F estimate for Renji is slightly under the HK$150.0m net profit guarantee mainly due to the consideration of taxes. Based on the announcement, Renji's effective tax rate in FY12/06 was only 6.2%. In our model, we have factored in an effective tax rate of 10.0% for Renji, which may have to be adjusted depending on the development of the government's tax unification initiatives.

Initiating coverage, target price HK$0.40. We initiate coverage on SIIS with a target price of HK$0.40, representing 28.5x FY12/08F P/E on a fully diluted basis assuming 11,808.2m shares. With China's increasing demand for healthcare services and high cancer mortality and SIIS' specialized and scalable business model, the company deserves to be trading at a premium to global healthcare plays' 21.6x forward one-year P/E. The target valuation is not aggressive given that it is at a pragmatic discount to the 41.5x traded by comparable China healthcare plays and 30.4x traded by peers in other emerging markets such as India.

Execution - the largest risk factor. With aggressive expansion plans comprising several acquisitions and business structure changes, effective execution is paramount, both to solidify the company's first mover advantage and to meet predefined profit targets. Other risks include: 1) closure of the acquisition deal; 2) regulatory risks in the healthcare industry; 3) ability to secure employees with necessary skills; 4) insurance liabilities; 5) significant escalation in market competition and 6) non-effective use of capital resources.

Previous fund raising activities. SIIS has previously conducted a series of fund raising activities, the latest of which was a HK$89.5m CB issued on 3 March 2007. The company currently has a total of three CBs outstanding, amounting to HK$108.5m. Of this, HK$5.0m is due to expire on 28 August 2008 (conversion price HK$0.11), HK$14.0m on 2 February 2009 (conversion price HK$0.10) and the remaining HK$89.5m on 3 March 2009 (conversion price HK$0.10).

Table 12: P&L

Year to Dec (HK$m)	05A	06A	07F	08F	09F
Turnover					
Investment holding	2.5	6.4	5.8	5.8	5.8
Financial services	29.1	59.2	121.3	-	-
Media, consulting, technology	20.1	2.8	0.3	-	-
Garment manufacturing	53.7	64.2	67.4	-	-
Property holding & others	7.1	7.9	8.7	9.2	9.6
Medical services	-	-	46.1	181.5	225.4
	112.4	**140.2**	**249.6**	**196.4**	**240.8**
Cost of sales	(62.9)	(74.8)	(70.5)	(15.5)	(16.0)
Gross profit	**49.8**	**65.5**	**179.0**	**180.9**	**224.8**
Other revenues	2.6	15.2	21.2	29.7	69.5
Distribution costs	-	-	-	-	-
Administrative expenses	(73.4)	(84.3)	(119.8)	(26.6)	(52.6)
Other operating income/(expenses)	9.1	1.5	(11.8)	(12.0)	(24.2)
Exceptionals	(42.4)	(18.2)	3.8	21.7	1.9
Operating profit	(54.6)	(20.3)	72.4	193.7	219.4
Finance costs	(4.2)	(6.3)	(7.0)	(5.2)	(4.9)
Share of results from associates	(33.6)	(54.7)	(4.8)	-	-
Profit before taxation	**(92.4)**	**(81.3)**	**60.6**	**188.5**	**214.4**
Taxation	(0.8)	(2.1)	(7.0)	(21.4)	(22.1)
Profit after tax	**(93.2)**	**(83.4)**	**53.6**	**167.1**	**192.3**
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	**(93.6)**	**(83.0)**	**52.3**	**166.6**	**191.8**
% chg	*n/a*	*11.3*	*n/a*	*218.4*	*15.1*
Dividends	-	-	-	-	-

Source: Company data

Table 13: Valuation comparison

Company name	Ticker	Country	Mkt Cap (US$m)	Last price (local)	Est Curr Yr P/E (x)	Est Nxt Yr P/E (x)	P/B (X)
Pacific Healthcare	PACH SP	Singapore	75	0.42	15.0	12.0	2.4
Thomson Medical	THOM SP	Singapore	132	0.70	22.4	17.8	2.6
Raffles Medical	RFMD SP	Singapore	400	1.33	28.3	21.8	5.4
Average					*21.9*	*17.2*	*3.5*
HK Healthcheck	397 HK	HK/China	171	0.47	n/a	n/a.	291.0
Quality Healthcare	593 HK	HK/China	127	4.15	12.6	n/a	3.7
China Healthcare	673 HK	HK/China	44	1.48	n/a.	n/a	11.0
Hua Xia Healthcare	8143 HK	HK/China	125	0.57	90.8	41.5	9.0
Average					*51.7*	*41.5*	*101.9*
Apollo Hospitals	APHS IN	India	627	495.10	36.5	30.4	4.1
Average					*36.5*	*30.4*	*4.1*
Sonic Healthcare	SHL AU	Australia	3,085	14.55	21.9	19.3	3.3
Ramsay Health	RHC AU	Australia	2,810	11.20	20.6	17.4	3.2
Primary Health	PRY AU	Australia	1,154	12.70	27.3	24.1	4.0
Average					*23.4*	*20.3*	*3.5*
Community Health	CYH US	US	3,659	38.22	16.4	14.6	2.0
Universal Healthcare-B	UHS US	US	3,332	62.30	20.0	17.8	2.3
Average					*18.2*	*16.2*	*2.2*
Generale de Sant	GDS FP	Europe	2,388	32.67	25.4	22.5	4.5
Rhoen-Klinikum	RHK GR	Europe	3,208	46.35	24.4	20.0	3.4
Average					*24.9*	*21.2*	*3.9*
Sector average					***27.6***	***21.6***	***24.5***

Source: Bloomberg

Disclosure of interests: SBI E2-Capital acted as the sole bookrunner and joint placing agent for the SIIS placement of 1,500m new shares (including an option for an additional placement of 200m new shares which was exercised in full) at HK$0.125 per share on 25 April 2007.
An Executive Director of SBI E2-Capital Securities is also an Executive Director of SIIS.
SBI E2-Capital is a joint venture between SIIS and E2-Capital (Holdings) Ltd. (378 HK).

P & L (HK$m)	05A	06A	07F	08F	09F
Year to Dec					
Turnover	**112.4**	**140.4**	**249.6**	**196.4**	**240.8**
% chg	*3.1*	*24.9*	*77.7*	*(21.3)*	*22.6*
Gross profit	49.5	65.6	179.0	180.9	224.8
EBITDA	(6.7)	2.1	82.4	201.7	249.5
Depre./amort.	(5.5)	(4.2)	(13.8)	(29.7)	(32.0)
EBIT	(12.3)	(2.0)	68.5	172.0	217.5
Net int. income/(exp.)	(4.2)	(6.3)	(7.0)	(5.2)	(4.9)
Exceptionals	(42.4)	(18.2)	3.8	21.7	1.9
Associates	(33.6)	(54.7)	(4.8)	-	-
Jointly-controlled entit.	-	-	-	-	-
Pre-tax profit	**(92.4)**	**(81.3)**	**60.6**	**188.5**	**214.4**
Tax	(0.8)	(2.1)	(7.0)	(21.4)	(22.1)
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Net profit	**(93.6)**	**(83.0)**	**52.3**	**166.6**	**191.8**
% chg	*n/a*	*(11.3)*	*n/a*	*218.4*	*15.1*
Dividends	-	-	-	-	-
Retained earnings	(93.6)	(83.0)	52.3	166.6	191.8
EPS (HK$) - Basic	(0.022)	(0.018)	0.008	0.014	0.016
EPS (HK$) - F.D.	(0.022)	(0.018)	0.007	0.014	0.016
DPS (HK$)	-	-	-	-	-
No. sh.s o/s (m) - W.A.	4,303.60	4,731.92	6,938.79	11,808.19	11,808.19
No. sh.s o/s (m) - Y.E.	4,311.38	4,976.29	9,686.29	11,808.19	11,808.19
No. sh.s o/s (m) - F.D.	4,303.60	4,731.92	7,822.92	11,808.19	11,808.19
Margins (%)					
Gross	*44.0*	*46.7*	*71.7*	*92.1*	*93.4*
EBITDA	*(6.0)*	*1.5*	*33.0*	*102.7*	*103.6*
EBIT	*(10.9)*	*(1.4)*	*27.5*	*87.6*	*90.3*
Pre-tax	*(82.2)*	*(57.9)*	*24.3*	*96.0*	*89.1*
Net	*(83.3)*	*(59.1)*	*21.0*	*84.8*	*79.7*

Balance Sheet (HK$m)	05A	06A	07F	08F	09F
Year to Dec					
Fixed assets	109.3	115.0	329.5	402.8	580.8
Intangible assets	-	-	450.0	427.5	406.1
Other LT assets	10.2	24.8	98.0	76.8	80.5
Cash	198.9	210.4	269.8	187.9	224.7
Accounts receivable	55.2	53.4	57.4	28.0	35.0
Other receivables	29.1	47.6	39.7	19.8	15.9
Inventories	8.0	10.6	10.1	-	-
Due from related co.s	-	-	3.7	4.3	5.0
Other current assets	-	-	-	-	-
Total assets	**410.7**	**461.8**	**1,258.3**	**1,147.3**	**1,348.0**
Accounts payable	(47.7)	(45.1)	(49.6)	(15.0)	(20.0)
Other payable	(38.9)	(74.8)	(85.1)	(20.7)	(26.9)
Tax payable	(1.3)	(0.7)	(0.6)	(0.6)	(0.6)
Due to related co.s	-	-	(33.5)	(28.0)	(32.0)
ST debts	(19.2)	(4.0)	(4.8)	(5.7)	(6.9)
Other current liab.	-	-	-	-	-
LT debts	(73.6)	(86.1)	(94.7)	(158.3)	(150.4)
Other LT liabilities	(8.9)	(1.8)	(1.9)	(1.9)	(1.9)
Total liabilities	**(189.6)**	**(212.5)**	**(270.2)**	**(230.3)**	**(238.7)**
Share capital	431.1	497.6	726.4	944.7	944.7
Reserves	(243.8)	(280.5)	(228.2)	(61.6)	130.2
Shareholders' funds	**187.3**	**217.1**	**954.6**	**883.1**	**1,074.9**
Minority interest	33.8	32.2	33.4	33.9	34.4
Total	**221.1**	**249.4**	**988.0**	**917.0**	**1,109.3**
Capital employed	313.9	339.4	1,087.5	1,081.1	1,266.6
Net (debt)/cash	106.1	120.3	170.3	23.9	67.4

Cash Flow (HK$m)	05A	06A	07F	08F	09F
Year to Dec					
EBIT	(12.3)	(2.0)	68.5	172.0	217.5
Depre./amort.	5.5	4.2	13.8	29.7	32.0
Net int. paid	(4.2)	(6.3)	(7.0)	(5.2)	(4.9)
Tax paid	(0.8)	(2.1)	(7.0)	(21.4)	(22.1)
Dividends received	(9.6)	0.6	0.5	0.5	0.5
Gross cashflow	**(21.4)**	**(5.7)**	**68.9**	**175.6**	**222.9**
Chgs. in working cap.	5.3	21.6	(39.7)	8.2	4.0
Operating cashflow	**(16.1)**	**15.9**	**29.2**	**183.8**	**226.9**
Capex	(2.1)	(2.4)	(206.0)	(103.0)	(210.0)
Free cashflow	**(18.2)**	**13.5**	**(176.8)**	**80.8**	**16.9**
Dividends paid	-	-	-	-	-
Net distribution to MI	(2.9)	(0.4)	0.4	(1.2)	(0.5)
Investments	(9.5)	(70.8)	(10.0)	(5.0)	(5.0)
Disposals	21.5	22.0	-	122.1	-
New shares	0.2	51.5	241.0	-	-
Others	10.2	(1.7)	(4.6)	(343.1)	32.2
Net cashflow	**1.3**	**14.2**	**50.0**	**(146.4)**	**43.6**
Net (debt)/cash - Beg.	104.7	106.1	120.3	170.3	23.9
Net (debt)/cash - End.	106.1	120.3	170.3	23.9	67.4

Interim Results (HK$m)	04A	05A	06A
Six months to Jun			
Turnover	**49.9**	**51.1**	**75.5**
% chg	*n/a*	*2.4*	*47.6*
Profit from operations	20.6	(18.7)	(5.1)
Interest expenses	(1.9)	(1.8)	(3.0)
Associates	1.0	(14.7)	(2.8)
Jointly-controlled entit.	-	-	-
Pre-tax profit	**19.7**	**(35.2)**	**(10.9)**
Tax	(0.3)	(0.3)	(2.4)
Minority interests	0.1	0.1	(0.2)
Net profit	**19.4**	**(35.3)**	**(13.5)**
% chg	*n/a*	*n/a*	*(61.7)*
EPS (HK$) - Basic	0.005	(0.008)	(0.003)
DPS (HK$)	-	-	-

Shareholding Structure	Shares o/s (m)	%
Leung Wing Shing	250.0	4.7
PMA Capital Mgt	243.7	4.6
Deutsche Bank AG	238.3	4.5
Publiic	4,612.7	86.3
Total	**5,344.7**	**100.0**

Background

SIIS is an investment conglomerate with a business interests spreading various sectors across China and Hong Kong including financial services, medical services, garment and technology.

Key Ratios	05A	06A	07F	08F	09F
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	na	na	8.9	18.1	19.6
EBIT ROCE (%)	na	na	9.6	15.9	18.5
Dividend payout (%)	-	-	-	-	-
Effective tax rate (%)	na	na	11.6	11.4	10.3
Net interest coverage (x)	na	na	9.8	33.2	44.2
A/R turnover (days)	110.8	141.1	81.0	79.4	47.7
A/P turnover (days)	87.3	120.6	69.2	60.0	26.5
Stock turnover (days)	40.4	45.5	53.7	118.8	-

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