

China Renji



BUY (unchanged)

Establishing foothold in Xian

Key points:

- Acquires PET-CT equipment from Xijing Hospital, one of Xian's largest hospitals, for RMB50.0m in cash
- We expect the set to be used to treat 100+ patients/month by end-2008, from around 50 in May
- Foothold in Xian's lucrative market justifies valuation
- Maintain BUY call, target price of HK\$0.20.

Acquiring PET-CT equipment from Xijing Hospital. China Renji (Renji) has acquired from a third party vendor one set of PET-CT equipment for RMB50.0m in cash. The equipment is located at the First Associated Hospital of the Fourth Military Medical University (第四军医大学第一附属医院) or "Xijing Hospital", in Xian.

Background of Xijing. Established in 1984, Xijing Hospital is one of Xian's largest hospitals. A Grade 3A hospital with about 2,500 beds, it employs about 2,000 professional, including about 400 specialist doctors. It currently has more than 40 specialty treatment centres and its PET-CT equipment is used for the diagnosis/detection of tumours/cancers, heart diseases and brain disorders. In 2007, Xijing hospitals treated around 1.6m out-patients and almost 70,000 in-patients.

Valuation at 5.0x P/S and 2.0x P/B. The vendor has warranted revenue of not less than RMB10.0m for the first and second years of operation, after the completion of the acquisition. Should the actual income fall below the warranted income, Renji will be entitled to cash compensation equivalent for 4x the difference, with a cap of RMB40.0m. The acquisition consideration represents a valuation of 5.0x price-to-sales and 2.0x net book value (as at 30 Apr 2008). Set up costs for the PET-CT totaled RMB26.0m. Under the profit sharing deal, the hospital will be entitled to 20% of the revenue, from completion of the deal to 2013, and 40% from 2013 to 2017.

Strong revenue growth prospects. The PET-CT set was installed at Xijing Hospital in Dec 2007. Still in the ramp up period, it generated revenue of RMB1.0m for the first four months of 2008 and was used to treat 130-140 patients. According to the management, it treated around 50+ patients in May, up from around 30 in Feb, suggesting good patient growth. We estimate the number of patients can exceed 100 per month by end-2008. Renji receives around 60% of PET-CT treatment fees (averaging RMB10,000-13,000/patient) received by the hospital.

Premium justified. At 2.0x P/B, the acquisition valuation is in the range of previous acquisitions such as Shenyang (2.5x) and Hefei (1.5x), while the Er Pao acquisition valuation was higher at 3.2x P/B. In our view, but this valuation is justified as the deal offers: 1) promising upside potential; 2) foothold in Xian's lucrative market. We expect that the set to be used to diagnose a number of diseases, not only for cancer/tumour cases.

China Healthcare

Mon, 16 Jun 2008

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Stock data

Price	HK\$0.085
Target price	HK\$0.20 (+135%)
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

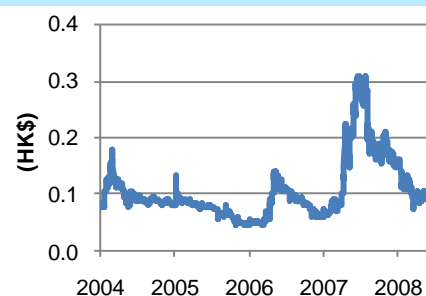
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	9.1	58.5	189.1	273.0	312.6
Net Profit (HK\$m)	(83.0)	12.8	34.0	100.8	133.0
EPS (HK\$m)	(0.018)	0.002	0.003	0.009	0.012
EPS Δ%	19.3	n/a	87.3	196.8	31.9
P/E (x)	n/a	53.4	28.5	9.6	7.3
P/B (x)	4.52	0.77	0.92	0.84	0.75
EV/EBITDA (x)	54.5	57.7	6.1	3.4	2.3
Yield (%)	-	-	-	-	-
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\$)	0.003	0.009	0.012
Previous forecasts (HK\$m)	34.0	100.8	133.0
Previous EPS (HK\$)	0.003	0.009	0.012

Price Chart



Maintaining our BUY call. The contribution from this acquisition is in-line with our expectations and therefore we have left our estimates unchanged at RMB34.0 for FY12/08F and RMB100.8m for FY12/09F (profit contribution from medical service operations of RMB128.4m in FY12/08F and RMB190.4m in FY12/09F). According to the company's CFO, the acquisition premium on the net book value of the equipment will be booked under goodwill, which will be subject to an annual impairment test. Any amortization of intangibles is unlikely. Our target price remains HK\$0.20, representing 22.0x FY12/09F P/E.

Table 1: Renji acquisition summary (since the 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)
Xian	Jun 2008	Expected end Jun 08	100.0	RMB50.0m (cash)	RMB10.0m (1 st yr*) RMB10.0m (2 nd yr*)

* after the completion of the acquisition

Source: Company data, SBI E2-Capital

Table 2: 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 3: 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

Disclosure of interests: 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	(64.0)	(26.9)	24.8
						Net cashflow	14.2	(141.3)	(48.0)	90.3	146.1
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)	(68.9)	21.4
DPS (HK\$)	-	-	-	-	-	Net (debt)/cash - End.	120.3	(21.0)	(68.9)	21.4	167.4
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	917.4	943.4	919.4	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	286.7	301.6	378.6						
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)	(68.9)	21.4	167.4						
						Key Ratios	06A	07A	08F	09F	10F
						Net gearing (%)	Cash	2.8	5.8	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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