

Renji acquisition progressing as expected Hong Kong Conglomerates

SIIS (648 HK, HK\$0.285)

BUY (unchanged)

Target price: HK\$0.45 (+58%)

Shareholders' Circular issued. SIIS issued the Shareholders' Circular regarding the acquisition of China Renji (Renji) on 18 June as scheduled. Key takeaways are as follows:

Accountants' Report

- Profit before tax of RMB29.5m was in line with previous announcement.
- In the Accountants' Report, the auditors made an over provision for tax expenses based on a tax rate of 33%, which is different from the 6% effective tax rate contained in the initial announcement on 25 Apr. Renji's management has told us that they will obtain formal approvals of confirmations from the respective PRC tax bureaus to allow the company to have an effective tax rate of around 10% going forward. The auditor has clearly stated in his report that any over provision may be reversed in subsequent years when such approvals/confirmations are obtained.

Valuation Report

- The valuation of RMB1.147b for Renji's business suggests that SIIS' acquisition consideration of HK\$641.0m in cash, shares and bonds was fair. However, while we agree with the method of valuation (using P/E and DCF), we believe that the Valuation Report was generally too conservative.
- We note that the market based valuation approach (P/E method) was based on historical P/E valuations of two US listed companies. In our view, this was extremely conservative given that: 1) historical P/E does not take into consideration the future earnings ability of the entity; 2) that Renji has much stronger earnings potential than the more mature US companies used in the valuation comparison; 3) the comparison with US listed companies is not appropriate as it fails to take into consideration the stronger growth dynamics of China's healthcare services sector and 4) the comparison fails to consider Renji's niche operations and first mover advantage.
- Similarly, the use of 17.2% as the discount rate for the DCF valuation is extremely conservative in our view. In the build up of the discount factor, we note that the Valuer has incorporated a "small company premium" of 6.36% to reflect Renji's small-company nature. We believe that this adjustment is unjustified. In our comparison of healthcare-related companies, the WACC was 7.6-11.2% for small-to-mid market caps and 8.2% for the whole sector.

Disposal of SBI E2-Capital Securities. On 12 Jun, SIIS said it had entered into an conditional agreement with an independent third party to dispose of its 49% interest in SBI E2-Capital Securities (SBI E2) for an aggregate consideration of HK\$76.8m. The consideration valuation was about 1.2x P/B, representing a slight premium on

Table 1: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	(93.6)	(0.022)	n/a	(13.1)	16.6	(210.0)	-	n/a	n/a	Cash
06A	(83.0)	(0.018)	(19.3)	(16.2)	14.3	659.6	-	n/a	n/a	Cash
07F	63.5	0.008	n/a	36.6	3.2	15.7	-	10.6	9.3	Cash
08F	154.8	0.013	66.5	22.0	3.5	6.6	-	16.6	16.1	Cash
09F	195.6	0.016	26.4	17.4	2.9	5.2	-	19.8	18.8	Cash

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the carrying value of SBI E2 on SIIS' accounts. The valuation was generally in line with our previous estimates. Though we had previously expected SIIS to dispose of SBI E2 in FY12/08F in order to focus on China's healthcare sector, the timing of the move was a positive surprise.

Revision of estimates. We have revised our forecasts slightly to factor in the earlier than expected disposal of SBI E2 and to incorporate the audited numbers from the accountants' report. We have revised up our FY12/07F net profit to HK\$63.5m (c.f. HK\$52.3m), and reduced our FY12/08F net profit to HK\$154.8m (c.f. HK\$166.6m). Our estimates currently assume the establishment of seven new cancer diagnosis and treatment centres in FY12/07 and four in FY12/08. Upside to our numbers will come from a more aggressive roll out schedule and/or any subsequent M&As. We understand that Renji is currently in talks to undertake the management of a chain that operates a series of medical centres across China.

Maintain BUY call, revising target price up to HK\$0.45. We have revised up our target price to HK\$0.45 (from HK\$0.40) after increased clarity on Renji's numbers and its faster-than-expected streamlining of operations. Our target price is derived from a DCF model based on a WACC of 10.0% and 5.0% terminal growth, reflecting the strong long-term growth trend of China's healthcare sector. The target price valuation represents 34.7x FY12/08F P/E.

Table 2: P&L

Year to Dec (HK\$m)	05A	06A	07F	08F	09F
Turnover					
Investment holding	2.5	6.4	15.8	16.6	17.4
Financial services	29.1	59.2	171.6	-	-
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	-	-	72.8	286.5	355.8
	112.4	140.2	336.6	312.2	382.8
Cost of sales	(62.9)	(74.8)	(150.9)	(126.7)	(152.8)
Gross profit	49.8	65.5	185.7	185.5	230.1
Other revenues	2.6	15.2	21.2	29.7	69.5
Distribution costs	-	-	-	-	-
Administrative expenses	(73.4)	(84.3)	(128.3)	(27.0)	(53.1)
Other operating income/(expenses)	9.1	1.5	(11.8)	(12.0)	(24.2)
Exceptionals	(42.4)	(18.2)	16.8	2.7	1.9
Operating profit	(54.6)	(20.3)	83.6	178.9	224.1
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)	71.8	173.7	219.2
Taxation	(0.8)	(2.1)	(7.0)	(18.4)	(23.1)
Profit after tax	(93.2)	(83.4)	64.8	155.3	196.1
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	(93.6)	(83.0)	63.5	154.8	195.6
% chg	n/a	11.3	n/a	218.4	15.1
Dividends	-	-	-	-	-

Source: Company data

Table 3: Updated fully diluted share calculation after acquisition

	At date of announcement		On completion of acquisition	
	No. of shares (m)	%	No. of shares (m)	%
Directors	39.4	0.7	340.3*	2.9
Placees	-	-	2,000.0	16.7
Vendor	-	-	2,710.0	22.7
Public	5,647.5	99.3	6,878.0**	57.7
Total	5,686.9	100.0	11,928.3	100.0

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

** Assumes the full exercise of 930.9m share options and the full conversion of convertible notes amounting to 600.5m shares

Source: Company data and SBI E2-Capital

Table 4: 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)	WACC (%)
Pacific Healthcare	PACH SP	Singapore	75	0.42	14.8	11.9	2.4	8.65
Thomson Medical	THOM SP	Singapore	136	0.72	23.1	18.8	2.7	7.58
Raffles Medical	RFMD SP	Singapore	467	1.55	33.0	25.4	6.2	7.81
<i>Average</i>					23.6	18.7	3.8	8.01
HK Healthcheck	397 HK	HK/China	135	0.37	n/a	n/a.	229.0	8.72
Quality Healthcare	593 HK	HK/China	117	3.82	11.6	n/a	3.4	8.39
China Healthcare	673 HK	HK/China	46	1.54	n/a.	n/a	11.5	8.06
Hua Xia Healthcare	8143 HK	HK/China	106	0.49	90.8	41.5	9.0	n/a
<i>Average</i>					51.2	41.5	101.9	8.39
Apollo Hospitals	APHS IN	India	650	512.80	35.4	31.5	4.5	11.22
<i>Average</i>					35.4	31.5	4.5	11.22
Sonic Healthcare	SHL AU	Australia	3,215	15.01	22.6	19.9	3.5	10.24
Ramsay Health	RHC AU	Australia	2,781	11.05	20.3	17.3	3.1	7.98
Primary Health	PRY AU	Australia	1,141	12.56	27.0	23.5	3.9	8.17
<i>Average</i>					23.3	20.3	3.5	8.80
Community Health	CYH US	US	3,801	39.71	17.0	15.1	2.1	6.14
Universal Healthcare-B	UHS US	US	3,288	61.45	19.8	17.6	2.3	7.01
<i>Average</i>					18.4	16.4	2.2	6.57
Generale de Sant	GDS FP	Europe	2,387	32.49	25.3	22.4	4.5	6.36
Rhoen-Klinikum	RHK GR	Europe	3,124	44.90	23.6	19.3	3.3	8.47
<i>Average</i>					24.4	20.9	4.5	7.42
Sector average					28.0	22.0	20.1	8.20

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).