SBI E2-Capital

Corporate Flash

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SIIS: Renji acquisition completed

Recommendation: BUY (unchanged) — **China Healthcare**

Price	**HK$0.255**
Target price	HK$0.45 (+76%)
12 mth range	HK$0.057-0.335
Market cap.	US$181.08m
Daily t/o, 3 mth	US$12.53m
Free float %	74.6%
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)	na	(11.7)	14.8	na	-	na	na	Cash
06A	(83.0)	(0.018)	(19.3)	(14.5)	12.8	584.2	-	na	na	Cash
07F	63.5	0.008	(144.4)	32.7	4.2	17.7	-	14.5	9.3	13.3
08F	154.8	0.013	66.5	19.7	3.1	5.8	-	20.0	14.0	Cash
09F	195.6	0.016	26.4	15.6	2.6	4.6	-	19.8	14.8	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -23.9%, +11.2%, +71.3%
Actual price changes (1 mth, 3 mth, 12 mth): -16.4%, +23.8%, +145.2%
Consensus EPS (07F-08F): HK$0.008, HK$0.013
Previous forecasts (07F-09F): HK$63.5m ($0.008), HK$154.8m ($0.013), HK$195.6m ($0.016)

Key points:

- Demonstrating its execution abilities, SIIS completes the acquisition of China Renji ahead of schedule. New management from Renji joins the Board of the listco.
- Swift expansion of Renji's scale and network on the way, with CD&T centres in Beijing and Jiangxi likely to be amongst the first.
- Expect further disposal of non-core assets, as SIIS squarely focuses on capturing China's healthcare industry.
- With key acquisition risk now eliminated, the stock is deserved of a re-rating. Currently trading at 19.6x FY12/08F P/E, the stock is undemanding.
- Re-iterate our BUY call with a DCF derived target price of HK$0.45, representing 34.7x FY12/08F P/E. Catalysts for further upward re-rating include: 1) announcements of establishment of new CD&T centres; 2) faster than expected execution and 3) acquisition of hospitals and/or other medical centres.

Renji acquisition completed. SIIS announced on 13 Jul 2007 that the acquisition of China Renji (Renji) was completed, ahead of the initial schedule. Accordingly, the 2,710m Consideration Shares (at HK$0.10 per share) and bonds amounting to an aggregate principal of HK$320.0m have been issued by SIIS to Renji. The cash consideration of HK$50.0m had already been previously paid out to Renji.

Re-shuffling of the Board. Renji will introduce several new members to the Board of SIIS. These include 3 new Executive Directors (including one as Co-Chairman) and 1 new Non-Executive Director. Former Chairman of the Board Dato' SJ Wong, has been re-designated as Co-Chairman in line with the re-shuffling.

Table 1: Additions to the SIIS Board

Name	Board Title / Role
Mr. Shen Yan	Executive Director and Co-Chairman
Ms. Duan Xuzhen	Executive Director responsible for financial management
Mr. Zhao Jun Jie	Executive Director responsible for business development
Ms. Sun Huali	Non-Executive Director

Source: Company data

Company name change to "China Renji' expected by the end of July. The proposal of name change of the listco from "Softbank Investment International (Strategic) Limited" to "China Renji Medical Group Limited" was also approved at the EGM held on 10 Jul 2007. The legal procedures are presently been undertaken and we expect the name change to be completed by the end of this month (July).

Business focus squarely on the China healthcare industry. The introduction of Renji management onto the SIIS Board together with the impending name change for the company is a strong signal to the investment community that SIIS is shifting its business focus from a broad-based financial services-to-technology conglomerate to the China healthcare industry, and in particular, the operation in medical centres specializing in the diagnosis and treatment of cancer in China. According to the Ministry of Health, cancer was 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).

Expect swift expansion of Renji's network. The placing of 1,500m shares (including the over-allotment of 500m shares) at the placing price of HK$0.125 per share was completed on 12 Jul 2007. The net proceeds of approximately HK$237.5m has been released to SIIS after the completion of the Renji acquisition and will be used for the expansion of Renji's network of cancer diagnosis and treatment centres (CD&T) in China by way of establishment of new centres and/or acquisitions. We presently estimate Renji's FY12/07F capex to be in the region of HK$206.0m. We are expecting a swift ramp up of the company's CD&T network as we understand that management has already been in deep negotiations regarding the set up of several new centres since the initial announcement of the acquisition on 25 Apr 2007. At this stage, we expect the establishment of CD&T centers in Beijing and Jiangxi to be amongst the first, though no details have been released yet.

Table 2: 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

Additional commentary on Shareholders' Circular. We had previously issued a report (see *Renji acquisition progressing as expected* (20 Jun 2007)) following the issue of the Shareholders' Circular: We have since conducted some additional analysis on the circular and our additional commentaries are described in the subsequent paragraphs. Some of the information from our previous research report has been recreated here to provide a more comprehensive picture.

Corporate structure

- Renji will have 100% control of Anping Medical Group, a limited liability company established in the PRC. At the date of the announcement, Anping Medical manages and operates its network of CD&T centres in China through 3 subsidiaries, namely Shanghai Hangyi Medical Management (100%-owned), Shanghai Anping Medical Equipment (83.3%-owned) and Shanghai SLK Medical Equipment Co (75%-owned).

Accountants' Report

- The Accountants' Report for Anping Medical Group covered the period from 13 Jun 2006 to 31 Dec 2006 only, with the former being the date of establishment of Anping Medical Group (ie. the relevant period of the audit was around 6.5 months).
- For the relevant period, China Renji (through Anping Medical) recorded revenues of RMB35.4m, with medical equipment leasing accounting for RMB14.8m (41.9%) and medical consultancy services of RMB20.6m (58.1%). Gross profit was RMB31.3m, implying a gross margin of 88.6%. The high gross margin was expected given that the company effectively books a net revenue. Renji receives and recognises its revenue as a specific percentage of the fees received by the hospitals. In general, Renji receives around 25% of the treatment fees received by the hospital as equipment leasing revenue and another 20% as medical consultancy revenue. The revenue is therefore "net" of all hospital expenses and thus, the majority of it is carried through to the gross profit line.
- Profit before tax was RMB29.5m, while net profit came in at RMB17.8m. The profit before tax was in line with our expectations.
- The net profit of RMB17.8m however, was below our expectations. The main discrepancy was related to

the tax expense. 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. Excluding the tax provision of RMB9.7m, the FY12/06A net profit would have amounted to RMB27.5m. The auditor has clearly stated in his report that any over provision may be reversed in subsequent years when such approvals/confirmations are obtained.

- While Renji requires upfront investment to expand its scale and network, the business model has strong cash generating abilities. The company's operating cash flow of RMB30.0m suggests that the majority of the company's RMB35.4m revenue is converted into cash. At the end of FY12/06A, the company had RMB17.9m cash with no debt.

Table 3: P&L of Anping Medical (13 Jun 2006 (date of establishment) to 31 Dec 2006)

13 Jun-31 Dec (RMBm)	06A
Turnover	
Leasing of medical equipment	14.8
Consultancy services fees	20.6
	35.4
Cost of sales	(4.0)
Gross profit	**31.3**
Other revenues	0.4
Administrative expenses	(2.3)
Profit before taxation	**29.5**
Taxation	(9.9)
Profit after tax	**19.5**
Minority interests	(1.7)
Profit attributable to shareholders	**17.8**
Dividends	-

Source: Company data

Table 4: Margins

13 Jun-31 Dec (%)	06A
Gross margin	88.6
Pre-tax margin	83.3
Net margin	55.3

Source: Company data, SBI E2-Capital

Table 5: Others

Year end Dec	06A
Inventory days	n/a
Receivable days	70.3*
Payable days	n/a
Net gearing ratio (x)	Cash (RMB17.9m)
ROE (%)	51.8*

*" * " Ratio calculated using proforma FY12/06E net profit of RMB32.9m, representing the audited FY12/06A net profit of RMB17.8m interpolated across a 12-month period.*

Source: Company data, SBI E2-Capital

Valuation Report

- The valuation of RMB1,147m 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.

More disposal of non-core assets on the way. After the announcement on 12 Jun, we are now expecting the disposal of SIIS to be completed by around mid Aug 2007. As a recap, SIIS entered into a 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 the carrying value of SBI E2 on SIIS' accounts at the end of FY12/06A. Besides this, we understand the company is also currently in discussions with independent third parties to dispose of its other non-core assets and we are expecting more announcements of this sort going forward. The move is in line with SIIS' strategic re-positioning to focus on China's healthcare sector.

With acquisition risk eliminated, re-iterating BUY call. With the completion of the Renji acquisition, management has clearly demonstrated its commitment to developing the cancer treatment and diagnosis business in China, while at the same time, eliminated one of the key risks associated with the stock. With acquisition risk eliminated, the counter is deserved of a re-rating. We re-iterate our BUY call on the stock with a DCF derived target price of HK$0.45, representing 34.7x FY12/08F P/E. Going forward, we see catalysts for further upward re-rating for the stock being: 1) announcements of establishment of new CD&T centres; 2) faster than expected execution and 3) acquisition of hospitals and/or other medical centres.

Table 6: 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 7: 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 8: 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 (%)
Thomson Medical	THOM SP	Singapore	139	0.72	24.0	20.0	2.7	7.58
Raffles Medical	RFMD SP	Singapore	526	1.55	34.4	25.8	6.2	7.81
Average					*29.2*	*22.9*	*3.0*	*7.70*
HK Healthcheck	397 HK	HK/China	137	0.38	n/a	n/a.	232.2	8.72
Quality Healthcare	593 HK	HK/China	116	3.78	11.5	n/a	3.3	8.39
China Healthcare	673 HK	HK/China	40	1.34	n/a.	n/a	11.5	8.06
Hua Xia Healthcare	8143 HK	HK/China	97	0.44	81.5	37.2	10.0	n/a
Average					*46.5*	*37.2*	*64.3*	*8.39*
Apollo Hospitals	APHS IN	India	632	495.35	40.9	37.0	4.5	11.22
Average					*40.9*	*37.0*	*4.5*	*11.22*
Sonic Healthcare	SHL AU	Australia	3,493	15.35	23.2	20.3	3.5	10.24
Ramsay Health	RHC AU	Australia	2,779	11.49	21.0	17.8	3.3	7.98
Primary Health	PRY AU	Australia	1,169	12.87	27.6	23.7	4.0	8.17
Average					*24.0*	*20.6*	*3.6*	*8.80*
Community Health	CYH US	US	4,027	42.07	18.1	15.9	2.2	6.14
Universal Healthcare-B	UHS US	US	3,204	59.49	19.1	16.5	2.2	7.01
Average					*18.4*	*16.4*	*2.2*	*6.57*
Generale de Sant	GDS FP	Europe	2,284	30.30	23.7	21.0	4.2	6.36
Rhoen-Klinikum	RHK GR	Europe	3,147	22.23	20.4	16.9	3.2	8.47
Average					*22.0*	*19.0*	*3.7*	*7.42*
Sector average					29.6	23.4	20.2	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 500m 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).

An Executive Director of a fellow subsidiary of SBI E2-Capital Securities Limited is a Non-Executive Director of SIIS.

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