China Renji

Progress made on key issues

BUY (unchanged)

China Healthcare

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Key points:

- Early solution to annual amortization charges
- Contract extensions from eight to 20 years with CD&T centres at 411 Hospital and 455 Hospital improving earnings stability and visibility
- One major acquisition to be announced by end-2008
- BUY call unchanged, HK$0.20 target price maintained. Counter trading at a steep discount to other healthcare-related plays.

Solution to the amortization issue. China Renji (Renji) announced on 19 August that it had replaced its auditor Deloitte with SLP Horwath. In our view this means that the company has made progress in solving its amortization issue, which involves booking about HK$54.0m a year in amortization costs related to the intangible asset of HK$359.4m arising from lease and consultancy contracts from the acquisition of Anping Medical in Jul 2007.

Working with partner hospitals and auditors. In April, Renji said it would work with its partner hospitals and auditors to minimize the impact of the amoritsation on its P&L. We understand that the new auditor has agreed to lower annual amortization charges after the company extended the contracts with 411 Hospital, 455 Hospital and Pudong Renji Hospital from an average of eight years to 20 years.

Positive Suprise. The announcement was a positive surprise as we previously expected the issue to be resolved by year-end at the earliest. The contract extension also improves Renji's earnings stability and visibility. The CD&T centres at 411 and 455 Hospitals in Shanghai are its core cash cows. We estimate that the two together generated 67.6% of its medical revenue in FY12/07A.

M&As. Since Apr 2008 (announcement of annual results), Renji has added five medical centres, in Xian, Shijiazhuang, Wuhan, Shenzhen and Shandong (Jinin), though these acquisitions are generally small in scale. However, we expect the company announce a large-scale acquisition before end-2008.

Revising up our estimates. We have left our revenue estimates unchanged but revised up Renji's net profit estimates by 27.9% to HK$43.5m for FY12/08F and 17.0% to HK$117.9m for FY12/09F. The revision is based on reduced amortization costs of HK$20.0m, partially offset by slight increases in non-cash derivative finance costs, stock option expenses and unallocated corporate overheads, which we have previously underestimated in our model.

1H FY12/08F preview. The company is due to announce its 1H FY12/08F results on either 19th or 22nd Sep. We expect the bottom line to come in at HK$11.8m. Note that Renji's results are heavily weighed towards 2H due to the combination of seasonally slower 1H (~45.0% of overall revenues). Many items, such as amortization, depreciation, finance costs, miscellaneous corporate expenses etc are booked 50.0% in 1H and 50.0% in 2H.

Stock data

Price	**HK$0.056**
Target price	HK$0.20 (+257%)
12 mth range	HK$0.057-0.230
Market cap.	US$96.6m
Daily t/o, 3 mth	US$0.41m
Free float %	70.5%
Ticker	0648.HK/648 HK

Financial summary

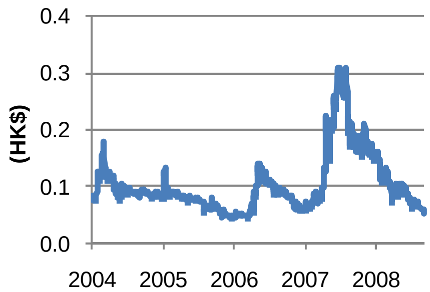
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK$m)	9.1	58.5	189.1	273.0	312.6
Net Profit (HK$m)	(83.0)	12.8	43.5	117.9	153.6
EPS (HK$)	(0.018)	0.002	0.004	0.010	0.013
EPS △ %	19.3	n/a	87.3	196.8	31.9
P/E (x)	n/a	35.2	14.7	5.4	4.2
P/B (x)	2.94	0.51	0.60	0.54	0.48
EV/EBITDA (x)	32.8	38.4	4.8	2.8	1.9
Yield (%)	-	-	-	-	-
ROE (%)	n/a	1.7	3.8	10.5	12.2
ROCE (%)	n/a	n/a	7.1	12.2	14.0
N. Gear. (%)	Cash	2.8	0.8	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(17.8)	(32.6)	(68.7)
Actual price changes (%)	(25.7)	(42.9)	(72.9)

	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	0.0090	0.0123

Price Chart



BUY unchanged, maintain target price. At only 2.8x EV/EBITDA and 5.4x P/E based on FY12/09F numbers, the counter is trading at a deep discount to peers. Healthcare plays in Singapore are trading at an average of 10.2x EV/EBITDA despite operating in a more mature and smaller addressable market, while Apollo Hospitals (APHS IN) in India is trading at a one-year forward EV/EBITDA of 11.1x. Our target price remains HK$0.20, representing 10.0x FY12/09F EV/EBITDA and 20.0x FY12/09F P/E.

Table 1: P&L

Year to Dec (HK$m)	06A	07A	08F	09F	10F
Revenues	**9.1**	**58.5**	**189.1**	**273.0**	**312.6**
Cost of sales	(0.9)	(33.8)	(35.3)	(42.8)	(44.5)
Gross profit	**8.2**	**24.6**	**153.8**	**230.2**	**268.0**
Other revenues	5.9	5.0	5.6	6.1	6.7
Distribution expenses	-	-	-	-	-
Administrative expenses	(40.0)	(64.1)	(55.2)	(56.5)	(57.6)
Exceptionals	(16.3)	(13.5)	-	-	-
Finance costs	(3.9)	(26.6)	(24.2)	(14.0)	(8.1)
Share of results from associates	(54.6)	(0.7)	-	-	-
Profit before tax	**(100.8)**	**(75.4)**	**79.9**	**165.9**	**209.1**
Tax	-	(1.5)	(33.0)	(42.9)	(49.6)
Profit from continuing operations	**(100.8)**	**(77.0)**	**46.9**	**123.0**	**159.4**
Profit from discontinued operations	17.3	93.7	-	-	-
Profit for the year	(83.4)	16.8	46.9	123.0	159.4
Minority interest	0.4	(4.0)	(3.4)	(5.0)	(5.8)
Net profit	**(83.0)**	**12.8**	**43.5**	**117.9**	**153.6**

Source: Company data, SBI E2-Capital