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China Renji: Anping on track to meet guarantee

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

Price	HK$0.163
Target price	HK$0.45 (+176%)
12 mth range	HK$0.057-0.335
Market cap.	US$227.6m
Daily t/o, 3 mth	US$12.5m
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	na	9.5	na	-	na	na	Cash
06A	(83.0)	(0.018)	(19.3)	na	8.2	353.0	-	na	na	Cash
07F	(11.6)	(0.001)	91.9	na	2.7	18.4	-	0.3	5.0	Cash
08F	157.3	0.013	na	12.6	2.1	3.7	-	21.1	14.8	Cash
09F	195.0	0.016	24.0	10.2	1.7	2.8	-	20.8	15.5	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +81.1%, -11.9%, -52.3%
Actual price changes (1 mth, 3 mth, 12 mth): -4.6 %, -42.8 %, +77.2%
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:

- Net profit came in at HK$4.7m in 1H FY12/07A, excluding Anping Medical's contribution and a one-off impairment charge of HK$42.6m.
- Anping Medical (subsidiary operating a network of CD&T centres in China) recorded an unaudited net profit of RMB35.6m, slightly above our expectations.
- We expect Anping Medical to meet its FY12/07 net profit guarantee of HK$80.0m thanks to contributions from new equipment at existing CD&T centres and solid patient growth, notwithstanding additional boost from acquisitions.
- First acquisition target likely in Beijing - located in a former military hospital in Beijing's Western District, the new CD&T centre operates body gamma knife (1), head gamma knife (1), linear accelerator (1) and Pet-CT (1).
- Up to five acquisitions are planned by end-FY12/07, with potential candidates in Shenyang, Xian, Hefei, Wuhan, Foshan and Jiangxi.
- We lift our net profit estimates for Anping to RMB85.7m in FY12/07F (c.f. RMB76.0m) and RMB156.3m in FY12/08F (c.f. RMB146.7m).
- We believe Renji's transformation into one of China's leading medical service centre networks remains on track, buoyed by better-than-expected results from Anping and its disposal of non-core assets. Expansion opportunities abound as cancer treatment equipment outside of key Chinese cities such as Shanghai and Shenzhen appear to be undersupplied.
- We re-iterate our BUY call on the stock with a target price of HK$0.45, representing 35x FY12/08F P/E. The counter is extremely undemanding; trading at 12.6x FY12/08F P/E and current levels offers a good opportunity to accumulate.

Listco's 1H FY12/07A results. As China Renji (Renji) completed the acquisition of Anping Medical's cancer diagnosis and treatment network only on 13 Jul 2007, the listco's 1H FY12/07 results do not incorporate any contribution from the healthcare services operations. Its interim revenue was up 27.6% YoY at HK$96.3m, driven by financial services (up 56.4% YoY at HK$53.8m), and gross profit up 32.7% YoY at HK$54.3m. Net loss came in at HK$38.0m compared with HK$10.9m a year ago, exacerbated by a HK$42.6m one-off impairment charge of the company's available-for-sale securities. Excluding this item, the listco actually recorded a small profit of HK$4.7m. Financial services' EBIT increased 23.5% YoY to HK$12.7m.

One-off impairment due to available-for-sale securities. The impairment of HK$42.6m was due to a write down in the listco's legacy available-for-sale securities and is not related to the listco's investment into the PRC lottery business (China Gloria). The investments written down are mainly associated with investment in securities and technology related investments. After discussion with the management, we do not expect any further significant write downs in 2H FY12/07F. Elsewhere, administration expenses grew 42.2% YoY to

HK$67.1m. This was mainly attributed to an expensing of share-based compensation of HK$5.2m, as well as a corresponding increase as a result of the strong performance in the listco's financial services segment.

Anping unaudited 1H FY12/07 net profit at RMB35.6m. Anping Medical (Anping), the main subsidiary operating a network of cancer diagnosis and treatment (CD&T) centres in China, recorded unaudited turnover of RMB46.7m in 1H FY12/07A and net profit of RMB35.6m. Note that in the company's shareholders circular regarding the Anping acquisition, Anping's net profit in FY12/06A for the period between 13 Jun-31 Dec was RMB17.8m. However, this included an over provision of tax expenses based on an effective tax rate of 33%. If a proforma number using the current effective tax rate of 9.0% was adopted for the FY12/06A figure, the adjusted FY12/06A net profit of RMB29.2m suggests that Anping grew 21.9% HoH. This is encouraging given that the company typically has a seasonally stronger 2H. Renji's management has re-affirmed us that they will obtain all of the formal approvals/confirmations from the respective PRC tax bureaus to allow the company to maintain an effective tax rate of between 9-11% going forward.

Table 1: 1H FY12/07A P&L of Anping Medical (unaudited)

(RMBm)	1H 07A
Turnover	**46.7**
Cost of sales	(3.4)
Gross profit	**43.3**
Other revenues	0.6
Administrative expenses	(6.9)
Profit before taxation	**37.1**
Taxation	(1.5)
Profit after tax	**35.6**
Minority interests	-
Profit attributable to shareholders	**35.6**
Dividends	-

Source: Company data

455 and 411 centres - main contributors. The 455 and 411 centres were the key contributors in the first half. We estimate that the 455 CD&T centre contributed RMB22.5m (48.2% of turnover) and the 411 CD&T centre RMB11.3m (24.2%). For comparison purposes, We estimate that 455 and 411 centre's turnover in FY12/06 was RMB31.5m and RMB18.0m respectively based on discussions with the management. Patient throughput at the 455 CD&T centre reached 1,900+, averaging RMB26,000 in a fee per patient. The 411 CD&T center's throughput was 1,000, with an average fee of RMB25,000. The higher average patient fee at the 455 CD&T centre was mainly due to the fact that the center deals with complicated tumour cases. Turnover growth at the two centers was driven by: 1) equipment expansion; 2) organic growth in patients and 3) growth in recurring patients. Management indicated about 10% of body gamma knife patients are remitting cases. As the treated patient base increases, we expect the number of remitting patients to rise as well providing stable growth for Anping. Anping typically offers a 20-30% discount on treatment fees for remitting cases.

Table 2: 455 & 411 CD&T centres operating metrics

CD&T centre	Patients Treated	*Est YoY growth (%)*	Avg fee per patient (RMB)
455 CD&T centre	1,900	*37.5*	26,000
411 CD&T centre	1,000	*50.0*	25,000

Source: Company data

Hospital investment income. The remaining RMB12.9m (27.6% of turnover) was related to Anping's hospital investment income. The company holds small stakes (<20%) in 6 CD&T centres including Shanghai Renji, 455 Healthcheck Centre and Beijing Yuquan amonst others. For this segment, Anping provides various management/professional consultancy services in return for a share of the net profits. Within this portfolio, Shanghai Renji accounted for around 25% (FY12/06: nil).

Anping on track for FY12/07 profit guarantee. We expect stronger 2H results because of long Chinese New Year and Labour Day holidays in the first half of the year and the fact that many Chinese tend to undergo major operations/treatments in the autumn period. We estimate the 455 centre's full year FY12/07F revenue at RMB49.5m and 411 CD&T centre's at RMB27.0m, putting the company well on track to attain its FY12/07 profit guarantee of HK$80.0m, notwithstanding any accretive boost from acquisitions.

First announcement of major acquisition imminent. We understand Renji's first major announcement on an acquisition of a CD&T centre is imminent and believe the most likely target is a CD&T centre in a former military hospital in Beijing, which is now under private management. We have recently visited the centre, located in Beijing's Western District, between the second and third ring road. The hospital has around 700 beds and expects to add 300 by 2009. The facilities at its CD&T Centre includes: 1 x body gamma knife, 1 x head gamma knife, 1 x linear accelerator and 1 x Pet-CT. The centre has been operating since June 2007. At present, the hospital does not offer health check services so its Pet-CT is used to support its cancer treating equipment. The centre, which has 35 employees and 11 marketing staff, plans to offer health checks in the future.

Promising prospects. The centre's management indicated that at present they are treating around 80 head patients and 60-70 body patients each month and expect to bring the number to 150 patients for each machine per month. Average fees are currently around RMB20,000/patient, slightly lower than Shanghai. Similar to Anping's 455 and 411 centres, the CD&T centre shares around 45% of medical fees received by the hospital.

Shortage of gamma knife equipment in Beijing. We understand that there is only three sets of body gamma knives and four sets of head gamma knives in Beijing at the moment, which suggests that demand should be strong (Shanghai has around 12 sets).

Up to five acquisitions planned by end-FY12/07. Including the potential Beijing acquisition mentioned above, the company plans to complete up to five acquisitions by end-FY12/07. Currently the management is in advanced discussions with centers in Shenyang, Xian, Hefei, Wuhan, Foshan and Jiangxi, and has around 30 potential targets on hand.

Disposal of other non-core assets on track. Renji's disposal of its non-core assets remains on track. The company has so far announced the disposal of, or disposed of, the majority portion of its financial services business, its 5.67% interest in E2-Capital (378 HK, HK$2.00, NR), majority portion of its property portfolio and its garment business. The company is in a net cash position of around HK$300m after the fund raising from the Anping acquisition. The proceeds from the disposal of these non-core assets are expected to add another HK$120-150m to fund Renji's medical network expansion in China. Renji's management plans to dispose of most of its remaining non-core business by the end of the year.

Table 3: Non-core business disposal summary

Item	HKEx announcement	Net proceeds (HK$m)	Valuation	P&L impact
Disposal of 49% interest in SBI E2-Capital Securities	Y	76.8	~1.0x P/B	nil
Disposal of 5.67% interest in E2-Capital (378 HK)	Y	23.2	~7.6x FY12/06A P/E	HK$3.9m gain
Disposal of ~80-90% of property portfolio	N	~50.0	na	~HK$2.0-5.0m gain
Disposal of garment business	Y	~20.0	~1.0x P/B	HK$0.82m gain

Source: Company data

Table 4: Remaining business to be disposed

Item	Approximate carrying value (HK$m)
SBI E2-Capital Securities (Singapore)	27
China Gloria (investment in PRC lottery business)	10
Remaining ~10-20% of property portfolio	<5
Remaining available-for-sale investments	35

Source: Company data

Revising up contribution from Anping. With better-than-expected operating metrics from its 455 and 411 CD&T centres, we have revised up our contribution from Anping Medical. We estimate Anping's net profit at RMB85.7m in FY12/07F (c.f. RMB76.0m) and RMB156.3m in FY12/08F (c.f. RMB146.7m). However, only around RMB39.3m will be consolidated into the listco in FY12/07F given its effective 5.5 month contribution. We will further lift our estimates after reviewing the details of any acquisition announcements. For the overall listco, we have now revised our estimates to a net loss of HK$11.6m for FY12/07F (c.f. net profit of HK$63.5m). We expect one-off items for the whole of FY12/07A to total HK$35.9m as the impairment charge in 1H FY12/07A is partially offset by gains from the disposal of non-core businesses in Table3. For FY12/08F, we project a strong rebound, with a net profit HK$157.3m (c.f. HK$154.0m), after taking into consideration: 1) Anping's increased contribution; 2) impairment charges in 1H FY12/07A; 3) higher financing costs and 4) lower contributions from non-core segments in FY12/08F.

Re-iterating BUY with target price of HK$0.45. Renji's growth prospects remain intact buoyed by Anping's better-than-expected interim results and the disposal of non-core assets. In our view, Renji's transformation into one of China's leading medical service centre networks (from an investment holding company) remains on track. We reiterate our view that Renji's niche focus on cancer diagnosis and treatment, relatively straightforward business model and higher margin model are its key advantages. With a shortage of cancer treatment equipment outside of China's key cities should create expansion opportunities for Renji. We re-iterate our BUY call on the stock with a target price of HK$0.45, representing 35x FY12/08F P/E.

Table 5: P&L

Year to Dec (HK$m)	05A	06A	07F	08F	09F
Turnover					
Investment holding	2.5	6.4	9.0	-	-
Financial services	29.1	59.2	71.8	-	-
Media, consulting, technology	20.1	2.8	0.1	-	-
Garment manufacturing	53.7	64.2	67.4	-	-
Property holding & others	7.1	7.9	8.3	-	-
Medical services	-	-	95.6	315.3	379.6
	112.4	**140.2**	**252.3**	**315.3**	**379.6**
Cost of sales	(62.9)	(74.8)	(106.7)	(126.1)	(149.4)
Gross profit	**49.8**	**65.5**	**145.6**	**189.2**	**230.2**
Other revenues	2.6	15.2	21.2	30.6	71.9
Distribution costs	-	-	-	-	(0.1)
Administrative expenses	(73.4)	(84.3)	(118.1)	(27.8)	(54.8)
Other operating income/(expenses)	9.1	1.5	(12.8)	(12.5)	(25.1)
Exceptionals	(42.4)	(18.2)	(32.1)	1.9	1.0
Operating profit	(54.6)	(20.3)	3.7	181.4	223.1
Finance costs	(4.2)	(6.3)	(8.9)	(6.7)	(6.4)
Share of results from associates	(33.6)	(54.7)	(1.0)	-	-
Profit before taxation	**(92.4)**	**(81.3)**	**6.2**	**174.8**	**216.7**
Taxation	(0.8)	(2.1)	(4.2)	(17.0)	(21.2)
Profit after tax	**(93.2)**	**(83.4)**	**(10.4)**	**157.8**	**195.5**
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	**(93.6)**	**(83.0)**	**(11.6)**	**157.3**	**195.0**
% chg	*na*	*na*	*na*	*na*	*24.0*
Dividends	-	-	-	-	-

Source: Company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital acted as the sole bookrunner and joint placing agent for the China Renji Medical Group Ltd (formerly known as Softbank Investment International (Strategic) Ltd) 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 China Renji.

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