

China Renji



BUY (unchanged)

Possible strategic acquisition

Key points:

- Framework agreement to acquire 100% of medical equipment maker MASEP Group
- Consideration of HK\$1,100m, represents 6.1x FY12/09F earnings based on a guaranteed profit of HK\$180.0m
- Renji's 1H FY12/08F net profit of HK\$26.5m boosted by higher-than-expected top line growth
- Net profit estimate lifted to HK\$68.7m for FY12/08 on stronger 2H due to seasonal factors and maiden contributions from new acquisitions
- BUY call unchanged, HK\$0.20 target price represents FY12/09F 9.0x EV/EBITDA and 18.0x P/E

Framework agreement. China Renji (Renji) announced on 22 Sep 2008 its framework agreement to possibly acquire the entire share capital of MASEP Group (MASEP) for a total consideration of HK\$1,100m. MASEP is a medical equipment manufacturer with a particular focus on gamma ray stereotactic equipment. According to the announcement, MASEP is the only China-developed head gamma knife system with accreditations from the US' FDA and China's SFDA. The company's equipment is sold in China, Vietnam and India.

Further details awaited. The framework agreement generally means that the parties are in acquisition talks and details of the deal are sketchy at the moment. The HK\$1,100m consideration will be satisfied in cash (HK\$300.0m), convertible bonds (HK\$305.0m) and new shares (HK\$495.0m). No details of the CBs, or the issue price of the new shares have been provided. The vendors have guaranteed that MASEP's net profit for 2009 will not be less than HK\$180.0m, implying an acquisition valuation of 6.1x.

Short and long term synergies. Short-term benefits: 1) EPS accretion (prior to any accounting treatment of CBs); 2) diversification into the fast growing medical equipment market; 3) tapping other emerging markets (Vietnam, India, Pakistan). Mid to long-term benefits: 1) opening up CD&T centre acquisition opportunities (MASEP has sold 38 sets gamma knife equipment in China to date); 2) elimination of potential competitor.

China Healthcare

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Kennedy Tsang

(852) 2533 3713

kennedytsang@sbi2capital.com

Stock data

Price	HK\$0.039
Target price	HK\$0.20 (+412%)
12 mth range	HK\$0.030-0.230
Market cap.	US\$57.0m
Daily t/o, 3 mth	US\$0.2m
Free float %	70.5%
Ticker	0648.HK/648 HK

Financial summary

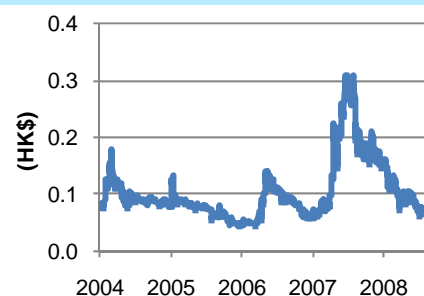
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	9.1	58.5	204.6	286.3	324.2
Net Profit (HK\$m)	(83.0)	12.8	68.7	127.3	161.4
EPS (HK\$)	(0.018)	0.002	0.006	0.011	0.014
EPS Δ%	n/a	n/a	278.8	85.3	26.8
P/E (x)	n/a	24.5	6.5	3.5	2.8
P/B (x)	2.05	0.36	0.41	0.36	0.32
EV/EBITDA (x)	20.6	27.1	2.8	1.6	0.8
Yield (%)	-	-	-	-	-
ROE (%)	n/a	1.7	5.9	11.0	12.4
ROCE (%)	n/a	n/a	8.2	12.6	14.1
N. Gear. (%)	Cash	2.8	2.4	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(23.1)	(32.8)	(64.5)
Actual price changes (%)	(33.9)	(44.3)	(76.1)

	08F	09F	10F
Consensus EPS (HK\$)	0.003	0.009	0.012
Previous forecasts (HK\$m)	43.5	117.9	153.6
Previous EPS (HK\$)	0.004	0.010	0.013

Price Chart



1H net profit surprises on upside. Renji's 1H FY12/08A net profit came in at HK\$28.3m (including a HK\$1.8m disposal gain) on turnover of HK\$87.2m. The gross margin was 78.4% and adjusted net margin 30.4%. The net profit results beat our forecast of HK\$11.8m mainly due to: 1) stronger-than-expected turnover and 2) lower-than-expected administration and tax expenses.

Key CD&T centres – strong performance. Shanghai 455's contribution grew 15.5% YoY to HK\$28.9m and Shanghai 411's 23.6% YoY to HK\$17.7m. Meanwhile, Er Pao CD&T's maiden six-month contribution was HK\$11.3m. Together, the top 3 CD&T centres accounted for 66.4% of total revenue.

Depreciation and amortisation charges adjusted. The company's 1H FY12/08A results are a re-calibration point, given expected adjustments to its depreciation and amortisation charges brought about by the reappraisal of the estimated useful lives of its medical equipment from 14 to 20 years and the lengthening of key contracts with 411 Hospital, 455 Hospital and Pudong Renji Hospital from an average of eight to 20 years. Depreciation and amortization charges for the interim period stood at HK\$10.1m and HK\$8.4m, respectively, down by HK\$2.0m and HK\$18.5m. Renji's administration expenses of HK\$23.7m were below our estimates, suggesting efficient cost controls. Stock option expenses reached HK\$9.0m.

Falling into place. Management appears to be delivering execution. With a seasonally stronger 2H and maiden contributions from new acquisitions (five medical centres since Apr 2008), we expect a stronger 2H contribution from Renji. As mentioned in our report *Progress made on key issues (3 Sep)*, one of the best surprises among the company's recent corporate developments was the extension of its key contracts with hospitals, which will significantly improve its earnings visibility.

Lifting FY12/08F forecasts. We have revised up our FY12/08F net profit estimate to HK\$68.7m after taking into consideration: 1) stronger than expected top line growth; 2) new cost structure adjusted for depreciation, amortization and administration expenses; 3) lower effective tax rate. We have also revised up our estimates for FY12/09F by 8.0% and FY12/10F by 5.1% to HK\$127.3m and HK\$161.4m respectively.

BUY unchanged, maintain target price. We re-iterate our BUY call on Renji, maintaining our previous target price of HK\$0.20, representing 9.0x FY12/09F EV/EBITDA and 18.0x FY12/09F P/E.

Table 1: P&L

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Revenues	9.1	58.5	204.6	286.3	324.2
Cost of sales	(0.9)	(33.8)	(43.1)	(55.8)	(58.6)
Gross profit	8.2	24.6	161.6	230.5	265.5
Other revenues	5.9	5.0	5.6	6.1	6.7
Distribution expenses	-	-	-	-	-
Administrative expenses	(40.0)	(64.1)	(46.6)	(47.6)	(48.2)
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)	96.2	175.0	216.0
Tax	-	(1.5)	(25.6)	(42.7)	(48.9)
Profit from continuing operations	(100.8)	(77.0)	70.6	132.3	167.1
Profit from discontinued operations	17.3	93.7	1.8	-	-
Profit for the year	(83.4)	16.8	72.4	132.3	167.1
Minority interest	0.4	(4.0)	(3.7)	(5.0)	(5.7)
Net profit	(83.0)	12.8	68.7	127.3	161.4

Source: Company data, SBI E2-Capital

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