

China Renji: First acquisition announced, more coming

Recommendation: BUY (unchanged)

China Healthcare

Price	HK\$0.163	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$0.45 (+176%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$0.057-0.335	05A	(93.6)	(0.022)	na	na	9.5	na	-	na	na	Cash
Market cap.	US\$227.6m	06A	(83.0)	(0.018)	(19.3)	na	8.2	353.0	-	na	na	Cash
Daily t/o, 3 mth	US\$12.5m	07F	(11.6)	(0.001)	91.9	na	2.7	18.4	-	0.3	5.0	Cash
Free float %	74.6%	08F	159.5	0.013	na	12.6	2.1	3.7	-	21.1	14.8	Cash
Ticker	0648.HK/648 HK	09F	198.5	0.016	24.5	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\$11.6m) (\$0.001), HK\$157.3m (\$0.013), HK\$195.0m (\$0.016)

Key points:

- Renji announced that it will acquire 51% of the CD&T centre at Er Pao Hospital in Beijing for RMB74.12m.
- Acquisition will be satisfied by RMB38.0m cash with the remaining in new shares (150.0m).
- Issue price of HK\$0.25 represents a premium of 53.37% to the last closing price of HK\$0.163 prior to the suspension of trade.
- FY12/08F attributable net profit guarantee of RMB10.2m implies an acquisition valuation of 7.3x P/E.
- Er Pao Hospital is centrally located between the Second and Third Ring Roads. The 2,000sqm CD&T centre is brand new, opened recently in Jun 2007.
- We expect the Er Pao acquisition to be the first of up to five acquisitions that Renji will announce prior to the end of FY12/07, which should provide a series of catalysts to the re-rating of the counter.
- The net profit guarantee was slightly above our expectations. Accordingly, we revise up our FY12/08F net profit estimate to HK\$159.5m (from HK\$157.3m). We re-iterate our BUY call on China Renji, keeping our target price at HK\$0.45, representing 35x FY12/08F P/E.

Acquiring 51% of CD&T at Er Pao Hospital. China Renji (Renji) announced its maiden acquisition immediately following the announcement of its interim FY12/07A results. As expected, the company will acquire an effective 51.0% stake of the CD&T centre at the Main Hospital of the Second Artillery Force (Er Pao), in Beijing.

Acquisition consideration RMB74.12m. Renji will effectively acquire 51.0% of the jointly co-operative CD&T centre between Shanghai Rentung and Er Pao Hospital. Renji will acquire from Shanghai Rentung 51.0% of the “wholly-owned medical equipment” and 51.0% the “50%-owned equipment” respectively. The acquisition consideration will amount to RMB74.12m, which will be satisfied as to RMB38.0m cash, with the remaining RMB36.12m by the issuance of 150.0m consideration shares to Shanghai Rentung. The issue price of HK\$0.25/share represents a premium of 53.37% to the last closing price of HK\$0.163/share prior to suspension of trade. At the date of the announcement, there were 11,178.7m shares in issue and the 150.0m new shares will represent approximately 1.33% of the share capital as enlarged by the consideration shares.

Table 1: Er Pao CD&T centre acquisition

Definition	Equipment	Acquisition Stake (%)	Effective Stake (%)	Remarks
Wholly-owned medical equipment	1 x head gamma knife 1 x body gamma knife 1 x linear accelerator 1 x tumour heat therapy system 1 x CT Sim Scan	51.0	51.0	n/a
50.0%-owned medical equipment	1 x Pet-CT	51.0	25.5	Remaining 50.0% is owned by Er Pao Hospital

Source: Company data

Consideration valuation at 7.3x FY12/08F P/E. Shanghai Rentung will guarantee that Renji’s attributable interest of the FY12/08F net profit generated from the CD&T centre to be no less than RMB10.2m. In the event that the net profit attributable to Renji is less than RMB10.2m in FY12/08F, Shanghai Rentung will compensate Renji by way of cash payment equal to an amount four times the difference between the guaranteed and actual net profit (compensation is capped at RMB38.0m). This guarantee implies an acquisition consideration of 7.3x FY12/08F P/E.

Er Pao CD&T opened in Jun 2007. The CD&T centre at Er Pao Hospital is brand new, opened in Jun 2007. As such, no proforma financials are currently available. However, as at 30 Aug 2007, the net book value of the medical equipment to be acquired by Renji amounted to RMB22.4m and the net profit attributable to Shanghai Rentung for the three months ending 30 Sep 2007 is estimated to be no less than RMB3.6m according to the announcement. Note that as part of the agreement, Renji will be entitled to 51.0% share of the income attributable to Shanghai Rentung for the 6 month period from 1 Jul 2007 to 31 Dec 2007, should the acquisition be completed. Therefore, we are expecting a nominal contribution from Er Pao’s CD&T centre for FY12/07F.

Background of Beijing Er Pao Hospital’s CD&T centre. The hospital is located in Beijing’s Western District, very centrally located between Second and Third Ring Roads (closer to Second Ring Road). The hospital was previously the government’s 262 Hospital, but has been under the private management of Er Pao since 2002. Er Pao currently has 700 beds and is expected to be expanded to around 1,000 by the end of 2009. The CD&T centre is approximately 2,000sqm in size. At present, the CD&T centre does not offer healthcheck facilities and so it only acts as a support to the cancer treating equipment. The management at the CD&T centre said that healthcheck facilities will be provided in future. Centre has around 35 employees plus another 11 personnel undertaking marketing activities.

Chart 1: Er Pao Hospital (1)



Source: Company data

Chart 2: Er Pao Hospital (2)



Source: Company data

Chart 3: Er Pao Hospital (3)



Source: Company data

Chart 4: Er Pao Hospital (4)



Source: Company data

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 100 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 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).

More negotiations in progress. As we have mentioned previously in "*Anping on track to meet guarantee (20 Sep 2007)*", the management is currently in advanced discussions with centres in Shenyang, Xian, Hefei, Wuhan, Foshan and Jiangxi.

Revising up FY12/08F net profit, re-iterating BUY call. We expect the Er Pao acquisition to be the first of up to five acquisitions that Renji will announce prior to the end of FY12/07. Though we have previously already factored this acquisition into our forecasts, the net profit guarantee was slightly above our expectations. We have left our FY12/07F net loss estimate unchanged at HK\$11.3m but revise up our FY12/08F net profit estimate to HK\$159.5m (from HK\$157.3m). We re-iterate our BUY call on China Renji, keeping our target price at 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	332.8	389.6
	112.4	140.2	252.3	332.8	389.6
Cost of sales	(62.9)	(74.8)	(106.7)	(133.1)	(153.4)
Gross profit	49.8	65.5	145.6	199.7	236.2
Other revenues	2.6	15.2	21.2	22.6	69.8
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	183.9	227.0
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	177.2	220.6
Taxation	(0.8)	(2.1)	(4.2)	(17.2)	(21.6)
Profit after tax	(93.2)	(83.4)	(10.4)	160.0	199.0
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	(93.6)	(83.0)	(11.6)	159.5	198.5
% chg	na	na	na	na	24.5
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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