

China Renji: Shenyang's turn to be acquired

Recommendation: BUY (unchanged)

China Healthcare

Price	HK\$0.171	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$0.45 (+163%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$0.06-0.34	05A	(93.6)	(0.022)	na	na	9.3	na	-	na	na	Cash
Market cap.	US\$248.4m	06A	(83.0)	(0.018)	(19.3)	na	8.0	353.0	-	na	na	Cash
Daily t/o, 3 mth	US\$2.1m	07F	(6.0)	(0.001)	(95.8)	na	2.9	39.0	-	(1.4)	5.1	Cash
Free float %	74.6%	08F	160.5	0.013	na	13.2	2.2	8.5	-	21.0	14.7	Cash
Ticker	0648.HK/648 HK	09F	199.7	0.016	24.4	10.6	1.8	6.7	-	20.6	15.4	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +10.3%, -33.1%, +72.1%

Actual price changes (1 mth, 3 mth, 12 mth): -6.3%, -9.7%, +150.7%

Consensus EPS (07F-08F): HK\$0.008, HK\$0.013

Previous forecasts (07F-09F): (-HK\$6.6m) (-\$0.001), HK\$159.5m (\$0.013), HK\$198.5m (\$0.016)

Key points:

- Renji announced its third acquisition - CD&T centre at Shenyang's PLA 463 Hospital comes after acquisitions in Hefei and Beijing.
- Consideration of RMB41.0m in cash, representing 4.1x P/E, is in line with our expectations.
- Shenyang PLA 463 Hospital is a Grade 3A hospital with over 50 years operating history.
- CD&T centre has one set each of body and head gamma knives, representing 50% of the available gamma knife equipment in Shenyang.
- Key acquisition given that Shenyang (population of 7m) is one of China's key industrial cities located in Liaoning province, which has eight cities with an aggregate population of about 30m.
- New CFO on board soon - ex-director of Shinewing, the largest domestic CPA firm in the China and Hong Kong region, and the first Chinese CPA firm fully certified to operate in both areas, will bring his corporate governance expertise to the company.
- With its swift execution of M&As in China's burgeoning healthcare industry, Renji remains our healthcare pick. We maintain our BUY call, with a target price of HK\$0.45, representing 35x FY12/08F P/E.

Acquisition of Shenyang PLA 463 Hospital gamma knife centre. China Renji (Renji) has announced its third acquisition after market close on Wednesday, 14 Nov. The structure of the deal will be similar to the Hefei acquisition previously announced. Renji's subsidiary, Anping Medical, will acquire 100% of the cancer treatment medical equipment (one set each of head gamma knife, body gamma and cobalt-60). Renji will be entitled to 70% of net profit generated by the equipment, with the remainder going to the current management of the CD&T centre.

Consideration represents 4.1x P/E. The consideration will be RMB41.0m by way of cash. As part of the agreement terms, the vendor has warranted the net profit attributable to Renji to be no less than RMB10.0m for each of the years from 1 Jul 07 – 30 Jun 08 and 1 Jul 08 – 30 Jun 09. This implies a valuation of 4.1x the warranted earnings for the year from 1 Jul 07 – 30 Jun 08. If the actual net profit falls below the warranted RMB10.0m in any of the two years, Renji will be compensated 5x the shortfall between the actual and warranted net profit.

Details of the CD&T centre. The center, which employs 17 staff including six full-time doctors, treats 70-80 patients per month, with around 50/50 split between the head and body gamma knives (the cobalt-60 generates negligible revenues). The CD&T centre receives 45% of the treatment fees received by the hospital, which average RMB14,000.0-18,000.0 per patient. Based on our discussions with the management, we estimate the centre treated more than 950 patients in 2006. According to the announcement, the CD&T centre generated a net profit of around RMB4.5m between 1 Jul 07 and 31 Oct 07, which puts it on pace to achieve a full-year net profit of around RMB14.0m. After excluding management fees of 30%, this roughly translates to an

attributable net profit to Renji of around RMB10.0m, in line with the warranted net profit. Under the terms of the agreement, Anping Medical will be entitled to the centre's profit from 1 Jul 2007.

Background of Shenyang PLA 463 Hospital. Shenyang PLA 463 Hospital is a 3A Grade hospital. It is centrally located, around 10 minutes from Shenyang's city centre. The hospital has been in operation for more than 50 years and has around 930 beds. The CD&T centre at Shenyang PLA 463 Hospital commenced operations in Apr 2004 and it has access to 30 beds in the hospital. The CD&T centre was set up with a view to provide gamma knife treatment services for tumours and radiotherapy to Shenyang and neighbouring cities.

Table 1: Renji acquisition summary (since completion of Anping Medical acquisition)

Project	Date	Acquired stake (%)	Consideration	Attributable profit guarantee	Acquisition valuation
Er Pao Hospital CD&T centre	Sep 2007	51.0	RMB74.12m (cash + new shares)	RMB10.2m (FY12/08)	7.3x FY12/08F P/E
Hefei Hospital	Oct 2007	100.0	RMB46.2m (cash)	RMB5.0m (FY12/07) RMB12.0m (FY12/08)	3.9x FY12/08F P/E
Shenyang PLA 463 Hospital CD&T centre	Nov 2007	100.0	RMB41.0m (cash)	RMB10.0m (07/07-06/08) RMB10.0m (07/08-06/09)	4.1x 07/07-06/08F P/E

Source: Company data, SBI E2-Capital

Adjacent cancer treatment centre ensures steady patient flow. Adjacent to 463 Hospital is the Liaoning Cancer Treatment Centre. The centre focuses on surgery and drug/chemotherapy forms of cancer treatment and does not have gamma knife equipment (it uses linear accelerators). The hospital funnels all patients requiring gamma knife treatment to the CD&T centre at PLA 463 Hospital. The centre's management indicated that because it is not government-affiliated, it finds it much harder to obtain approval from the Ministry of Health to set up a gamma knife operation. As a testament to the difficulty, Shenyang currently has only four sets of gamma knives.

Key acquisition in industrial zone. In our view, this is a key acquisition for Renji. Shenyang is the largest urban centre in northeastern China. Its location at the centre of the Northeast Asia Economic Zone and the Bohai Rim has allowed Shenyang to develop into the country's key industrial city. Its population of around 7m ensures a large catchment area. In addition, Liaoning province has eight cities with an aggregate population of about 30m.

New CFO soon to be on board. Renji will soon have a new CFO. He is the ex-director of Shinewing (HK) (信永中和), the largest domestic CPA firm in the China and Hong Kong region, and the first Chinese CPA firm fully certified to operate in both areas. In China, Shinewing is second only to the Big Four international accounting firms. The addition of his accounting/auditing expertise will no doubt strengthen Renji's corporate governance. After he joins the company, executive director Duan Xuzhen, who currently performs CFO duties, will focus more on Renji's strategic development.

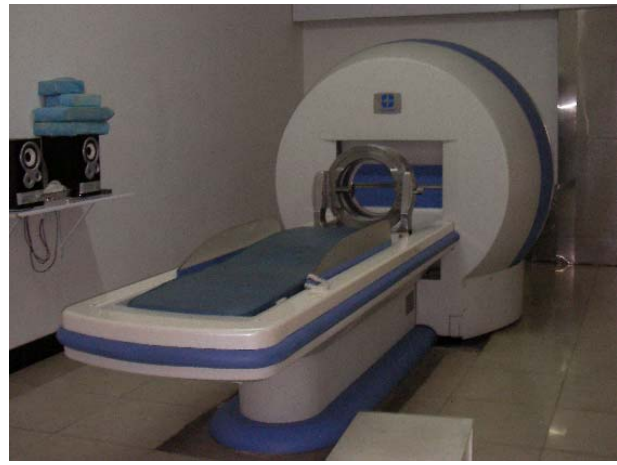
Reiterate BUY call, target price HK\$0.45. Though we had already factored this acquisition into our P&L model, the contribution from Shenyang's CD&T centre in FY12/07F is actually slightly higher than our expectations. As a result, we have revised up our FY12/07F net loss estimate to HK\$6.0m and FY12/08F net profit estimate to HK\$160.5m. We expect Renji to announce at least one, possibly two acquisitions by end-2007. The net profit contribution from Hefei Hospital is in line with our projections. With its swift execution of M&As in China's burgeoning healthcare industry, Renji remains our healthcare pick. We maintain our BUY call on the counter, with a target price of HK\$0.45, representing 35.0x FY12/08F P/E.

Chart 1: Hefei Hospital (1)



Source: Company data

Chart 2: Hefei Hospital (2)



Source: Company data

Chart 3: Hefei Hospital (3)



Source: Company data

Chart 4: Hefei Hospital (4)



Source: Company data

Table 2: 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	-	-	86.5	334.6	391.7
	112.4	140.2	243.3	334.6	391.7
Cost of sales	(62.9)	(74.8)	(103.1)	(133.8)	(154.2)
Gross profit	49.8	65.5	140.2	200.8	237.4
Other revenues	2.6	15.2	21.2	22.6	69.8
Distribution costs	-	-	-	-	(0.1)
Administrative expenses	(73.4)	(84.3)	(115.3)	(27.8)	(54.8)
Other operating income/(expenses)	9.1	1.5	(9.6)	(12.5)	(25.1)
Exceptionals	(42.4)	(18.2)	(30.9)	1.9	-
Operating profit	(54.6)	(20.3)	13.2	185.0	228.2
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)	(0.5)	178.3	221.9
Taxation	(0.8)	(2.1)	(4.2)	(17.3)	(21.7)
Profit after tax	(93.2)	(83.4)	(4.7)	161.0	200.2
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	(93.6)	(83.0)	(6.0)	160.5	199.7
% chg	na	na	na	na	24.4
Dividends	-	-	-	-	-

Source: Company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the sole bookrunner and placing agent for the China Renji Medical Group Ltd (formerly known as Softbank Investment International (Strategic) Ltd) in April 2007.

An Executive Director of SBI E2-Capital Securities Ltd. is also an Executive Director of China Renji Medical Group Ltd.

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

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

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2007. All rights reserved.