

China Public Healthcare

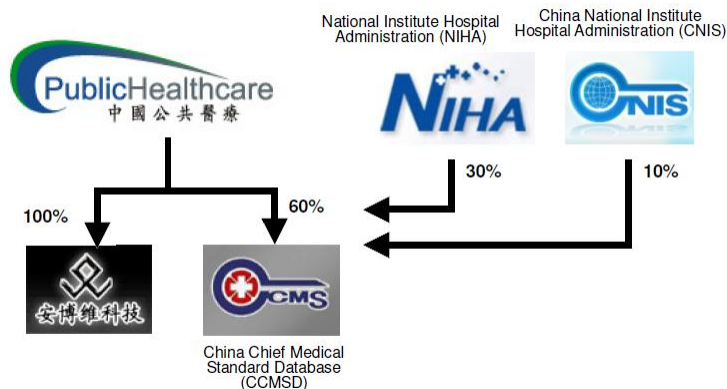
A sound play in hospital IT market

to summarize...

- Successfully tapped into healthcare system business with strategic partners
- Sound product quality, promotion channels and payment collection
- Signed a few contracts with medical associations and regional government
- Expect to generate income in 2010
- Considered CB conversion, FY12/10F P/E on fully diluted basis is 10.6x

Tapping into healthcare system businesses in 2H 2009. In Oct 2009, the company completed an acquisition of a medical IT systems business at a consideration of HK\$498m by issuing CB with conversion price at HK\$0.168 per share. After the completion, China Public Healthcare has 60% equity interest in the acquired entity, where the remaining 40% are held by National Institute Hospital Administration (“NIHA”) and China National Institute of Standardization (中國標準化研究院) (“CNIS”). Through the shareholders structure, the company has aligned long-term exclusive cooperation agreement with relevant government bodies of the healthcare industry. Figure 1 shows the two strategic partners shareholding on the company. Table 1 shows the major businesses provided. Each of them shows their own uniqueness or status.

Figure 1. Two strategic partners: NIHA and CNIS



Source: Company data

Table 1. Businesses units of China Public Healthcare at a glance

Products and services	Remarks
Electronic medical records system (EMR)	The only searching and matching systems in EMR systems that meets standard of MoH
Regional health service community information platform	Use wireless medical technology to solve villagers medical problem in rural area
Hospital pre-evaluation service	The only healthcare surveillance and analytics system recognized by MoH
Radio trucking systems integration	Legacy business, to be disposed
Mining business	Legacy business, to be disposed

Source: Company data

Ticker	8116 HK
Rating	Not Rated
Price (HK\$)	0.122
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.097-0.455
Market cap. (US\$m)	176.3
Daily t/o (US\$m)	1.4
Free float (%)	54.3

Financial summary (hospital IT business only)

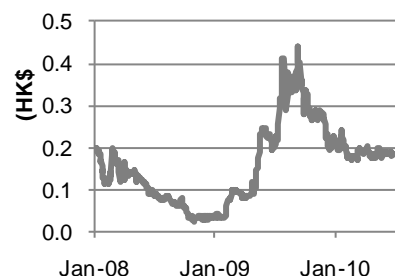
Year to Dec	1H 10A
Turnover (HK\$m)	279.1
Net Profit (HK\$m)	122.3
EPS (HK\$)	0.0075
P/E (x)	--
P/B (x)	2.27
EV/EBITDA (x)	11.81
Yield (%)	--
ROE (%)	13.9
ROCE (%)	13.9
N. Gear. (%)	14.5

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (RMB)	0.013	0.019	0.027
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(34.3)	(40.0)	(68.2)
Actual price changes (%)	(32.2)	(38.1)	(67.9)



Source: Bloomberg

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Product segments. Currently, major core businesses of China Public Healthcare are electronic medical records system (EMR), regional health service community information platform and hospital pre-evaluation service.

- Electronic medical records system (EMR) – CPH developed its record system with independent intellectual property. According to the management, it is the first Chinese language-based medical information software for medical institutions. It is 1) one of the systems conformed to MoH's EMR information standards; 2) the only system conformed to Chinese Herbalist Management Office of MoH Chinese herbalist standard. The management points out that the system data is searchable, transferrable and compatible with all sorts of HIS system. It facilitates data flow for the convenience of patients, hospitals as well as government.
- Regional health service community information platform – CPH use wireless medical technology to solve villagers' medical problem. The company covers the up-front investment including equipments and networks. Medical staff is trained to provide nursing support and perform simple medical procedures at the rural health service community, while doctors in urban area could perform diagnosis remotely for villagers in rural area. Technically, it reduces administrative pressure on the hospital side since it no longer needs to have doctors in rural area and it does not involve investment. It also provides a platform to manage health records of villagers.
- Hospital pre-evaluation service – CPH cooperates with hospital experts and develops its own evaluation software to research problems in hospital management. Its pre-evaluation service is authorized by NIHA and Chinese Hospital Association. According to national standard, the company can give accurate evaluation score to hospital. Hospitals are subject to actual evaluation by the government to determine its status and approved level of fee schedule. Pre-evaluation service essential prepares hospital for the actual assessment and facilitates hospital upgrades.

Table 2. Description and major progress existing core businesses

Products and services	Description	Major Progress
Electronic medical records system	EMR system for Chinese herbalist hospitals	Co-operation with China Medical Sciences Academy
	EMR system for professional medical commission	Co-developed system for Chinese Liver Diseases Association
	EMR system for urban community	Signed contracts or in talks with a 6 cities
Regional health service platform	Tele-medical Clinics (rural health service)	Signed contracts or in talks with a 6 cities
	EMR system in rural area	Signed contracts or in talks with a 6 cities
Hospital pre-evaluation service	Perform pre-accreditation analysis	Working with China Hospital Management Association

Source: SBI E2-Capital

Revenue model. The revenue models for each of CPH's products are as follows:

- Electronic medical records system (EMR) – CPH cooperates with regional government, associations, professional medical commission and individual hospitals to its sell EMR system. For instance, the company approach a regional government and the government could sign contracts for EMR systems for all the hospitals within the region. Under such arrangement all fees are paid by the government. While construction project cycle is 3 years, CPH gradually recognizes income and profit over the period as sales income. For each hospital, the company is going to charge RMB1m, subject to the number of beds in the hospital, generally equivalent to RMB2,000 to RMB3,000 per bed. Upon large scale purchase such as sales to Chinese Liver Diseases Association, contract size could reach RMB80m, with a good portion is subsidized by overseas pharmaceutical company. After installation, CPH could charge a maintenance fee at around 10% of installation fee after 1-year free maintenance.
- Regional health service community information platform – For tele-medical clinics, CPH pays all the upfront investment and receives medical income over cooperation period such as 20 years. After setting up the network and equipments, the tele-medical clinics are open to villagers. While a villager patient may pay RMB20, CPH is entitled to RMB80 from the government according to the subsidy program that covers medical in rural area. CPH received RMB100 from each service. While a certain percentage of income as fess and operational expenses, CPH is expected to receive recurrent income for the relatively long cooperation period. Currently, there are 4 to 8 patients per day, while the company targets to have 10 patients per day in longer run. Other than tele-medical services, EMR system in the rural area is charged at RMB0.65m per hospital, generally 20% to 30% lower than the charge in the urban area.
- Hospital pre-evaluation service – pre-evaluation service generally require 1 year for the assessment. Upon completion of the assessment, report will be issued to the hospital and recommendations are possibly made. CPH could recognize a one-time service income for each of these projects. Service charge for high level hospital is RMB1m, while the charge for middle level is RMB0.5m.

A well-positioned company in the sector. We believe China Public Healthcare is competitive in the following ways such that the company should be able to win contracts from local governments and various hospitals in China.

- Products qualification – The strategic partners of China Public Healthcare are NIHA and CNIS, the business arms directly under Ministry of Health and General Administration of Quality Supervision, Inspection and Quarantine (國家質量監督檢驗檢疫總局). China Public Healthcare closely follows the standards and specifications in regulation on the nationwide level and developed copyrights. For instance, the company provides hospital pre-evaluation system services using the same set of accreditation system as in the official evaluation. The company could provide qualified systems and services that well-fits regulatory requirement, in our view.
- Product demand driven by both government regulations and healthcare restructuring needs – Currently China Public Healthcare has: 1) electronic medical records (EMR) system, 2) tele-medical clinics services and 3) hospital pre-evaluation services. Item 1) is required by law and we understand that CPH's EMR system is currently the only one of its type that has passed MoH scrutiny; Item 2) eases doctors the pressure of practising medicine in rural area, one of the key problems in upgrading the standard of medical

services in rural areas; Item 3) upgrades the hospital revenue structure by increasing emphasis on healthcare services fees (less reliance on revenue from selling of pharmaceutical products).

- Reduced receivables risk – One advantage of CPH is that it is able to negotiate directly with local and provincial governments. For the EMR systems, once the relevant terms have been agreed and signed, the government essentially subsidises the installation of the systems at all hospitals under its jurisdiction coverage. This effectively reduces risk for the company to secure its contracts. Default of payment is less likely. By the end of 1H FY12/10A, outstanding amount of trade receivables was HK\$274.7m, a relatively high level compared to its sales in 1H FY12/10A. However, noted that the age of around HK\$187.5m trade receivable was 0-30 days, while it is relatively common to see ages of government related receivables of 30days+.

Net profit from hospital IT systems reached HK\$122.3m for 1H FY12/10A. Turnover from hospital IT systems (continuing operations) was HK\$279.1m for 1H FY12/10A, while net profit was HK\$122.3m. Of the HK\$279.1m revenue, EMR systems contributed the largest part by HK\$180m, equivalent to 65% of revenue from continuing operations. In terms of profit, the segment contributed 92% of total profit for 1H FY12/10A. During the period, 140 general hospitals and 40 Chinese hospitals has completed installation of the EMR systems. On the other hand, regional health services community information platform contributed HK\$84m to revenue. Tele-medical clinic in Fuxin City, Liaoning was completed by the end of June and the one in Danzhou City, Hainan began. However, they were still at the early stage and the segment was essentially at breakeven for 1H FY12/10A. While hospital pre-accreditation service provided only HK\$15m revenue in 1H FY12/10A, the management targeted to complete 300 hospitals by the end of the year. By the end of 1H FY12/10A, the company had HK\$487.7m goodwill and HK\$274.7m trade receivables on the balance sheet.

Revenue estimates for various segments. Based on the company's contracts on hands, we put a few assumptions and prepare a simple forecast of revenue for 2010. Table 3 shows our revenue estimates for various segments. For FY12/10F, we believe EMR systems will make up near 50% revenue for the year. Regional health service platform may be contributing 30% while pre-evaluation service may make up the remaining 20%. Total revenue may reach RMB432m, in our view.

Table 3. Revenue estimates

RMBm	FY12/10F	remarks
EMR system for Chinese herbalist hospitals	120	Currently workforce support limit; ASP at RMB1m each
EMR system for professional medical commission	80	Contract size with respect to Chinese Liver Diseases Association
Tele-medical Clinics (rural health service)	73	Consultant services in 3 cities; assume 10 patients /day for 300 days
EMR system in rural area	59	Assume 1 region to complete in 2010; ASP RMB0.65m each
Evaluation system for hospitals	100	100 hospital to be completed in 2010; ASP at RMB1m each
Total revenue	432	

Source: SBI E2-Capital

Our view. Our back of pad estimate applying 40% net profit margin indicates a net profit of RMB173m (while net profit of 1H was HK\$122.3m, equivalent to 70% of our estimates). By the end of Jul 2010, total number of shares in circulation is 11,270m shares. Additional 5,057m new shares can be converted from CB at HK\$0.04 per share. Therefore, on a fully diluted basis, EPS for FY12/10F could be RMB0.01. Based on current share price of HK\$0.12 and currency rate at RMB1 for HK\$1.1469, P/E for FY12/10F would be 10.6x.

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