

Medical China: A resources play in Cambodia

Recommendation: Not Rated

Hong Kong Resources

Price	HK\$0.58	Yield (12/06A)	na
12 mth range	HK\$0.02-0.61	ROE (12/06A)	(27.3)
Market cap.	US\$62.1m	Net gearing (12/06A)	Net cash
No. shares o/s	835.0m	Net cash/sh. (12/06A)	HK\$0.08
Daily t/o, 3 mth	US\$0.8m	BV/sh. (12/06A)	HK\$0.11
Free float %	64.5%	Consensus EPS	
Major shareholder	PME – 25.4%	- 3/07F	na
Ticker	8186.HK/ 8186 HK	- 3/08F	na

Key points:

- Proxy to Cambodia's emerging resources boom.
- Acquisition cost at a steep discount of not less than 94.0% to its intrinsic value.
- Multiple sources of income generate strong FCF.
- High profitability thanks to surging sawn timber and rubber prices and low input costs.
- Assets injections in the pipeline.
- Strong government links with officials on the company's advisory board.

Investment summary. Southeast Asia presents great investment opportunities, especially as China is maturing and valuations are skyrocketing. Resource-rich Cambodia, with its emerging economy, investor-friendly environment and tremendous growth potential is particularly attractive amid the surging commodity prices, driven by China's and India's growing appetite for resources such as timber and rubber, mounting inflation pressure, dwindling natural resources worldwide and excessive liquidity. Medical China's forestry concession will allow it to tap Cambodia's emerging resource boom and establish a strong foothold in the timber and rubber industries there. Valued at a substantial discount to its intrinsic valuation, the acquisition is EPS and shareholders' value accretive. Further assets injections are in the pipeline.

Foray into Cambodia. Listed on the GEM board of HKEX in December 2001, Medical China is mainly engaged in the research, development and provision of medical devices for cancer treatment, including RFAS and 3-dimensional laparoscope. It also promotes anticancer drugs in China and manufactures and sells medical testing equipment in the mainland and overseas. The group plans to acquire from (Cambodia) Tong Min a 100.0% stake in the 70-year concession of natural forests in Cambodia granted by the Cambodian government. The total consideration of not more than HK\$200.0m represents a steep discount (not less than 94.0%) to the asset's intrinsic value of US\$412.8m. It will be satisfied by the issuance of new shares, non-convertible bonds and cash (from internal resources of Medical China). After the acquisition, shareholders of (Cambodia) Tong Min will become the company's single largest shareholder. To better reflect its new business nature, Medical China will be renamed China ASEAN Resources Ltd. We also expect it to gradually divest its medical businesses and focus on the resources development business in Cambodia.

Triple revenue streams. The company plans to set up a rubber tree plantation in the concession area, clearing the forest five years before the plantation starts to produce. It will process the salvage into sawn timber for sale. It will also set up a plant to turn the sawn timber into flooring materials. Another main revenue stream will come from rubber sales, once the plantation starts operations.

Location. The concession area, covering 10,082.0 hectares (gross) or 7,500.0 hectares (net), is located in Kratie province, Cambodia, about 370km away from capital Phnom Penh (linked by National Highway No.6 and National

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Highway No.7) and about 25km from Cambodia's major river, the River Tonle Mekong.

Transportation. The products from the concession area will be first taken to the port in Praek Kampi via National Highway No.6 and National Highway No.7. The estimated transport time is about 12 hours. Then, the cargo will be shipped to Vietnam's Ho Chi Minh port for transshipment to China. The cargo can also be shipped from the forest to Ho Chi Minh via Tonle Mekong (transport time about 24 hours) at 1/8th of the highway transportation cost.

Forest clearing. The group will hire professional logging companies for extraction and processing. According to the Chinese Academy of Forestry, the forest has about 3.2m³ of logs, with premium grade logs representing 5.3%, first grade logs 43.1% and standard grade logs 51.6%. Premium grade logs include disopyros sp, dalbergia bariensis and pterocarpus pedatus. First grade logs include Afzelia xylocarpa and sindora cochinchinensis. Standard grade logs include hopea, shorea obtuse, dipterocarpus spp, gonystylus macrophyllum, tarrietia javanica as well as largerstroemia calyculata, helicia sp and schleicheria oleosa.

Flooring material. The group plans to set up a flooring material factory with annual production capacity of 48,000 m³, which should come on stream at the beginning of FY12/09F. It will process standard grade sawn timber. The ASP of the low grade log is estimated at US\$165.0/m³ and that of flooring at about US\$350.0/m³. After the forest clearance by end-FY12/11F, the plant will have to source sawn timber from third parties.

Rubber tree plantation and latex extraction. The group will plant rubber trees in phases as the forest gets cleared. About 74.4% of the concession area (7,500 hectares) is expected to be used for rubber trees, which should start produce latex by the end of FY12/12F. Each hectare of rubber trees is estimated to yield 0.7 tons of latex per annum, five years after planting and 1.6 tons after eight years. The concession area should yield about 12,000 tons of latex per annum, or 1.6 tons per annum per hectare by the end of FY12/19F.

Operating model. To develop the plantation, the company plans to either hire professional managers (management model) or work with a resource company in China (cooperation model). Under the cooperation model, the project will be eligible for Chinese government subsidies amounting to 30.0% of its total investment. The Chinese partner would assume all the investment and expenditure related to the plantation in return for discount price latex, which means the company will have to give up some profitability but will be free from the hassle of arranging marketing, transportation and logistics. As latex pricing depends on the market price, the cooperation model will still allow the company to enjoy some upside. In our view, this model allows the company to avoid capital expenditure and minimize risks. Since its partner will be highly committed to the project, execution risks should be reduced as well. Finally, the company will still be able to enjoy the upside of rubber prices based on the pre-determined pricing model but without market risks, as the partner will take all of the plantation's output.

Earnings and FCF streams. Sawn timber sales will be the company's major revenue source between FY12/08F (92.0% of sales) and FY12/12F. Its flooring material plant should come on stream in FY12/09F. Between FY12/09F and FY12/11F, sawn timber will generate 89.2% of total revenue and flooring material 10.8%. Free cash flow (FCF) and net earnings are expected to increase at a three-year CAGR of 26.0%, to HK\$502.3m and HK\$492.8m, respectively. Since the first harvest of latex is scheduled for end-FY12/12F and salvaged log resources will be exhausted by end-FY12/12F, we expect the company's FCF and earnings to decline 74.9% YoY to HK\$95.2m and 77.6% to HK\$110.5m during the year. They will increase at a seven-year CAGR of 23.7% to HK\$337.9m and 21.5% to HK\$429.8m, respectively, between FY12/13F and FY12/20F. We do not expect the project to yield any revenue in FY12/07F.

Revenue model - sawn timber. We conservatively estimate the total amount of logs available for extraction at 1.25m³, compared with the Chinese Academy of Forestry's figure of 3.2m³. No revenue is expected from the division in FY12/07F. However, since log extraction does not require much preparation, the group may extract some logs and produce sawn timber immediately after the acquisition, deriving some sales revenue from sawn timber or raw logs between 3Q and 4Q FY12/07F. The division's blended profit margin is estimated at 70.5% and its major cost components are production (30.5% of total COGS), inland transportation (22.9%), outbound transportation (45.7%) and operating tax (1.0%). We assume that the company will transport sawn timber from the concession via national highways. Should it float it down the Tonle Mekong River, transportation expenses will be reduced by 87.5%. The operation will be terminated at end-FY12/12F when salvage logs are exhausted.

Table 1: Sawn timber division

	2007F	2008F	2009F	2010F	2011F	2012F
Production volume (m ³)	0	213,180	313,500	344,850	344,850	37,620
ASP (US\$/m ³)	0.0	242.0	242.0	253.6	265.8	278.7
EBITDA (HK\$m)	(2.7)	270.4	351.6	444.3	470.6	54.4
Net profit (HK\$m)	(4.0)	265.2	346.4	439.1	465.4	44.3

Source: SBI E2-Capital

Revenue model - flooring materials. The company plans to source all of its sawn timber from the concession area between FY12/09F and FY12/11F and after that from outside. The division's major cost components include production (0.6%), labor (2.5%), operating tax (13.1%) and raw materials (83.7%). No transfer pricing is factored in between FY12/09F and FY12/11F in our model. Between FY12/09F and FY12/11F, we assume the plant will source timber from the concession area at the external selling price. The division's average blended margin between FY12/09F and FY12/13F is projected at 21.6%.

Table 2 : Flooring material division

	2009F	2010F	2011F	2012F	2013F
Revenue (HK\$m)	91.9	96.5	101.3	106.4	111.7
Gross profit (HK\$m)	18.5	19.4	20.5	21.5	30.3
EBITDA (HK\$m)	8.4	10.8	11.3	12.0	20.2
Net profit (HK\$m)	6.8	9.2	9.8	10.4	18.6

Source: SBI E2-Capital

Revenue model - rubber production. Although it will take eight years for trees to mature, they will start producing latex about five years after planting. Between FY12/07F and FY12/11F, the company will incur plantation, forest management and seedling expenses. After the cultivation stage, which will end in FY12/12F, the only expenses will be related to operating tax and forest management fees. The first harvest of latex is expected in FY12/12F and the plantation should fully mature in FY12/19F, producing 12,000 tons of latex annually.

Table 3: Rubber plantation cost projections

	2007F	2008F	2009F	2010F	2011F
Plantation area (hectares)	1,200.0	1,500.0	1,600.0	1,600.0	1,600.0
Seedling cost (HK\$/hectares)	3,907.25	4.0	4.1	4.3	4.4
Seedling per hectare (unit)	560	560	560	560	560
Plantation expenses (HK\$/hectares)	5,470	5,634	5,803	5,977	6,157
Total costs (HK\$m)	(3.8)	(14.6)	(15.8)	(16.2)	(16.6)

Source: SBI E2-Capital

Table 4: Rubber plantation production projections

	2012F	2013F	2014F	2015F	2016F
Production per hectare (ton)	0.70	1.00	1.20	1.60	1.60
Total production volume (ton)	840	2,250	4,060	6,440	8,960
Revenue (HK\$m)	18.3	51.6	97.8	162.8	237.9
Gross profit (HK\$m)	13.7	39.9	81.5	140.0	207.6
EBITDA (HK\$m)	12.8	35.3	72.7	125.4	186.2
Net profit (HK\$m)	10.2	24.1	54.0	96.1	144.8

Source: SBI E2-Capital

Valuation of the asset. The group will acquire operating rights to the concession area for no more than US\$25.0m (US\$2,479.7/hectare) compared with selected timber companies' average EV/hectare of US\$12,877.0. Currently, listed forestry companies are trading at an average one-year forward P/E of 25.2x and two-year forward P/E of 18.9x. Based on the peer average two-year forward P/E, the group's sawn timber division and flooring materials division should be valued at US\$609.0m. However, as the asset is subject to a number of risk factors (execution, country, legal and political), our revenue model and the company's business plan are subject to a high degree of uncertainty. Thus, we prudently adopt a 50.0% discount to the benchmark to derive the valuation of US\$304.0m. Assuming a WACC of 10.5% (based on the average cost of equity of selected peers), 1.0% terminal growth rate and an operating period of 34 years, we arrive at the rubber plantation's net present value (NPV) of US\$217.7m. Again, we conservatively adopt a 50.0% discount to our NPV to derive the valuation of US\$108.9m. Based on the valuations of the three divisions, we put the concession's valuation at US\$412.8m, substantially above its current price tag.

Table 5: Peer group comparison (P/E)

Company name	Ticker	Year End	Currency	Price	Market Cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward
Ta Ann Holdings	TAH MK	Dec	MYR	11.5	712.8	13.9	12.0
Jaya Tiasa Holdings	JT MK	Apr	MYR	5.35	436.5	26.1	8.6
WTK Holdings	WTKH MK	Dec	MYR	8.95	453.5	9.9	8.9
Lingui Development	LING MK	Jun	MYR	3.46	659.1	16.6	9.6
Evergreen Fibreboard	EVF MK	Dec	MYR	1.92	266.1	12.2	8.0
Timberwest Forest	TWF-U CN	Dec	CAD	17.99	1,304.6	19.9	11.4
International Forest Products	IFP/A CN	Dec	CAD	9.1	406.4	98.9	28.3
Sino-Forest	TRE CN	Dec	CAD	16.0	2,672.6	14.4	12.1
Weyerhaeuser	WY US	Dec	USD	80.6	17,561.5	45.0	28.9
International Paper	IP US	Dec	USD	38.8	16,895.7	17.5	14.9
Rayonier Inc	RYN US	Dec	USD	45.1	3,494.9	22.3	22.6
Potlatch Corp	PCH US	Dec	USD	42.5	1,658.8	24.6	21.1
Plum Creek Timber	PCL US	Dec	USD	41.8	7,383.2	27.6	24.9
Fletcher Building	FBU NZ	Jun	NZD	12.5	4,773.3	14.6	13.6
Gunns Ltd	GNS AU	Jun	AUD	3.2	1,011.9	14.1	12.8
UPM-Kymmene Oyj	UPM1V FH	Dec	EUR	18.4	12,922.7	15.9	12.6
Samling Global	3938 HK	Jun	HKD	2.94	1,618.8	17.5	15.5
<i>Average</i>						<i>25.2</i>	<i>18.9</i>

Source: SBI E2-Capital, Bloomberg

Table 6: Peer group comparison (EV/hectare)

Company name	Ticker	Forest area (m Hectare)	EV (US\$m)	Market Cap (US\$m)	EV/hectare (US\$)
Ta Ann Holdings	TAH MK	0.04	712.8	712.8	19,414
Jaya Tiasa Holdings	JT MK	1.92	539.6	436.5	282
Timberwest Forest	TWF-U CN	0.33	1,486.2	1,304.6	4,449
Sino-Forest	TRE CN	0.36	3,061.0	2,672.6	8,622
Weyerhaeuser	WY US	13.36	24,901.5	17,561.5	1,864
International Paper	IP US	0.55	21,405.7	16,895.7	38,593
Rayonier Inc.	RYN US	1.09	4,113.8	3,494.9	3,790
Potlatch Corp.	PCH US	0.50	1,950.5	1,658.8	3,910
Plum Creek Timber	PCL US	3.16	8,843.2	7,383.2	2,800
Gunns Ltd	GNS AU	0.11	1,429.1	1,429.1	12,478
UPM-Kymmene Oyj	UPM1V FH	2.60	18,397.3	12,922.7	7,084
Samling Global	3938 HK	3.45	1,776.5	1,731.7	516
<i>Average</i>					<i>12,877</i>

Source: SBI E2-Capital, Bloomberg

Table 7: DCF valuation of rubber plantation

	12F-16F	17F-21F	22-26F	27F-31F	32F-36F	37F-41F
Free cash flows (HK\$m)	434.6	1,416.8	1,882.1	2,411.2	3,086.5	3,948.4
DCF (HK\$m)	290.3	633.1	514.0	399.7	310.6	655.4
NPV as of the end of FY12/07	1,701.5					
Cost of equity (%)	10.5					

Source: SBI E2-Capital

More acquisitions in the pipeline. (Cambodia) Tong Min is in the process of obtaining concessions to three forests covering more than 30,000 hectares. If the company succeeds, its shareholders may inject the concessions into the listco, which should aid the cash flow and fill the earnings gap before the rubber tree plantation starts contributing after salvaged log resources are exhausted. The move would also increase the group's resource base and expand its revenue and earnings size. Indeed, the listco will serve as a fund raising platform for projects in Cambodia.

Strong government links. (Cambodia) Tong Min has strong and extensive ties to the Cambodian government. Its chairman, Zhang Zhengzhong, has been doing business in Cambodia for five years. The company has a number of government officials on its advisory board, such as Tol Chao (deputy chief of Cabinet of the Prime Minister, first deputy commander of Prime Minister's Body Guard, a "Three-star" General of Cambodia's army and head of the National Forest Guard of Cambodia), Kim Hong Mak (advisor to the Prime Minister), and Pheng Muthavy (deputy head of the Department of Rubber Development of Cambodia, a department of the General Directorate of Rubber

Plantations - responsible for the rubber development plan including laws and regulations). With their assistance, (Cambodia) Tong Min can identify and gain access to lucrative investment projects in the country and deal with the Cambodian bureaucracy smoothly.

Inherent risk factors. Execution risks – 1) geopolitical and legal risks in Cambodia; 2) price risks - sawn timber, rubber and flooring material products. Our model does not take into account any revaluation gains or losses of biological assets.

(Cambodia) Tong Min's management profile. CEO - Zhang Zhengzhong - responsible for devising and implementing the group's strategic business plan in Cambodia including liaison with the government and exports of timber products to China. He has been involved in various businesses in Cambodia since 2000, including the export of timber products and import of equipment and machinery. Has also been active in promoting business and cultural exchanges between Cambodia, China and other countries, including trade exhibitions in Copenhagen, Prague and Belgrade, as well as promoting football matches for Red Star Belgrade in China. Prior to establishing his own import and export business in China in 1995, Zhang was head of the Shanghai division of a state-owned export & import company. In 1968-1992, he was Deputy General Manager of Wen Wei Po, one of Shanghai's leading Chinese-language newspapers and Deputy Factory Manager of Shanghai Electric (2727 HK).

COO – Qu Zhaoning - in charge of the forestry operations. Has extensive experience in forestry surveying and harvest planning. Acted as Senior Forestry Engineer and Deputy Head of the Central South Forest Inventory and Planning Academy (中南林业勘察规划设计院). He graduated from the Beijing Forestry University in 1962.

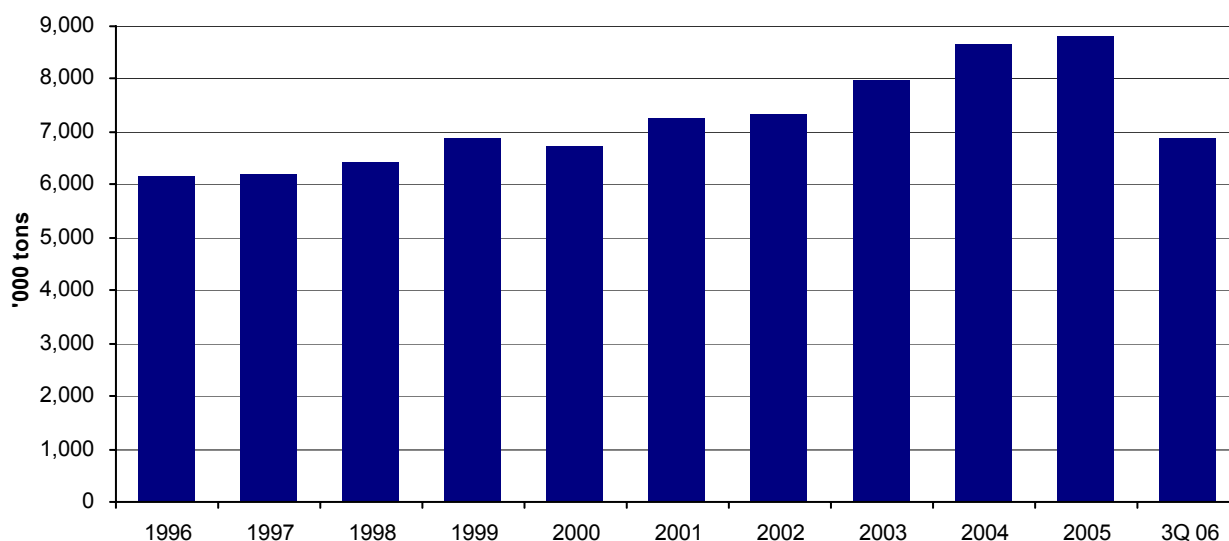
CFO - Alan Leung- responsible for financial management and investors relations. Acted as CEO of SteMing Asia, a Hong Kong-based regenerative medical company prior to joining the group. Between 2001 and 2006, was an associate director of AIG Investment Corp responsible for private equity investments in Asia. Also executive director of Eu Yan Sang International, a Singapore listed herbal medicine company with operations in Southeast Asia and Greater China from 1999 to 2001. A member of Australia's Institute of Chartered Accountant and the Hong Kong Institute of Certified Public Accountants. Holds a bachelor's degree in commerce from the University of New South Wales in Australia and a master's degree in business and administration from the Chinese University of Hong Kong.

What is rubber tree? Hevea brasiliensis, or simply rubber tree, belongs to the family of Euphorbiaceae. Economically significant, it produces sap-like extract known as latex, which is the primary source of natural rubber. The tree can reach a height of over 30.0m. Harvesting begins when trees are five to six years old. Incisions are made orthogonal to the latex vessels, just deep enough to tap the vessels without harming the tree's growth, and the sap is collected in small buckets. This process is known as rubber tapping. Older trees yield more latex, but they stop producing after 26-30 years. The wood, parawood or rubberwood, is used in the manufacture of high-end furniture. It is valued for its dense grain, minimal shrinkage, attractive colour and acceptance of different finishes. It is considered "environmentally friendly" as it makes use of trees that have been cut down at the end of their latex-producing cycle.

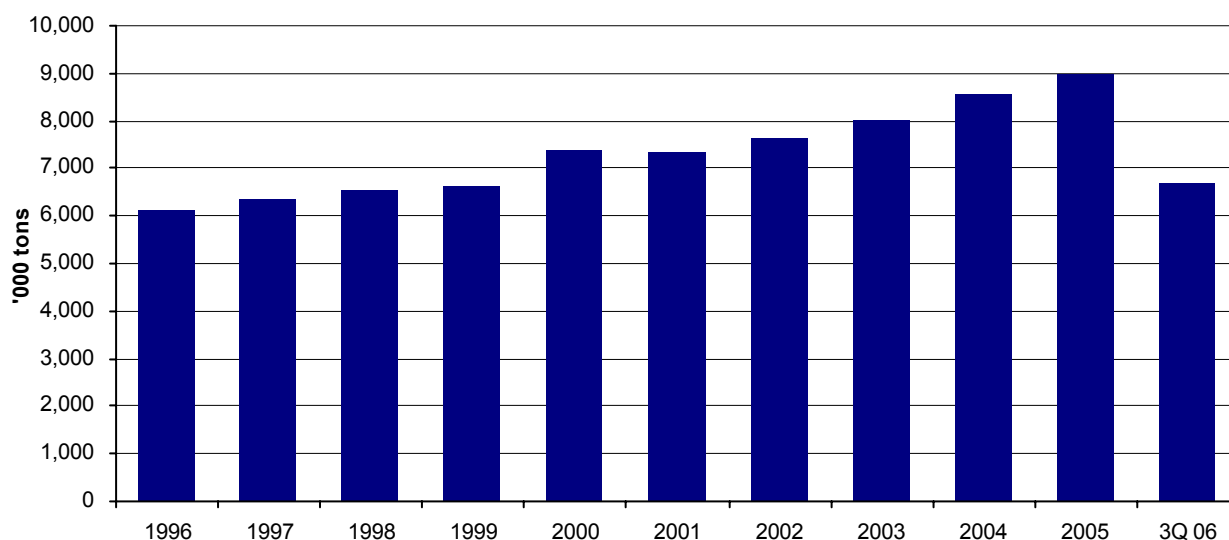
Application of natural rubber. Rubber is an elastic hydrocarbon polymer that naturally occurs as a milky colloidal suspension, or latex, in the sap of some plants. It can also be synthesized. It is widely applied in various industries. The tire and tube industries are the largest consumers of rubber, following by the general rubber goods (GRG) sector. The car industry also consumes significant amounts of rubber.

Rubber plantation in Cambodia. Currently, Cambodia has seven state-owned rubber plantations, accounting for 64.0% of the country's rubber production volume. Three private plantations account for 8.0% of the country's rubber output.

Price to stay strong. According to the Association of Natural Rubber Producing Countries, the world's natural rubber consumption increased at a nine-year CAGR of 4.4% to 9.0m tons between 1996 and 2005, while global production increased 4.0% to 8.8m tons in the period. In general, rubber consumption outstrips supply globally. The natural rubber price was stable in 2000-2002 and then started rising again. Between 1997 and 2006, the Malaysia Rubber Board Rubber FOB price increased at a nine-year CAGR of 11.1%. Global economic growth is the major factor influencing the price and demand. According to the International Monetary Fund's (IMF) April projection, the world's economic growth will slow to 4.9% in 2007 from 5.4% in 2006. However, given rubber's broad application, its demand growth rate is not expected to retreat as much as the global economic growth. The excessive liquidity in the global capital market will support all commodity prices, including that of natural rubber. The International Rubber Study Group expects global rubber consumption to increase at an annual rate of 4.7% between 2007 and 2009 while production is expected to grow 3.9% in the period, which bodes well for the price of rubber.

Chart 1: Global natural rubber production volume

Source: The Association of Natural Rubber Producing Countries

Chart 2: Global natural rubber consumption volume

Source: The Association of Natural Rubber Producing Countries

Price gap to narrow. The price of crude oil, used to make synthetic rubber, also affects the price and demand of natural rubber. Based on New York, TSR20 (NR) and USA SBR Export Value (SR), the price discrepancy between natural and synthetic rubber increased from negative US\$72.0/ton in 2005 to US\$642.0/ton in 2Q06. Thereafter, the difference dropped to US\$31.0/ton in 4Q06 and picked up to US\$236.0/ton in 1Q07. Although the price gap has been widening since 1Q07, we expect it to narrow by 3Q07, as the crude oil price has remained above US\$65.0 since the beginning of June.

Table 8: Discrepancy between natural rubber and synthetic rubber price

Product	2005	1Q06	2Q06	3Q06	4Q06	1Q07
New York, TSR20, (US\$/tonne)	1,535.0	2,036.0	2,291.0	2,254.0	1,869.0	2,205.0
USA SBR Export Values (US\$/tonne)	1,607.0	1,648.0	1,649.0	1,703.0	1,838.0	1,969.0
Difference (US\$/ton)	(72.0)	388.0	642.0	551.0	31.0	236.0

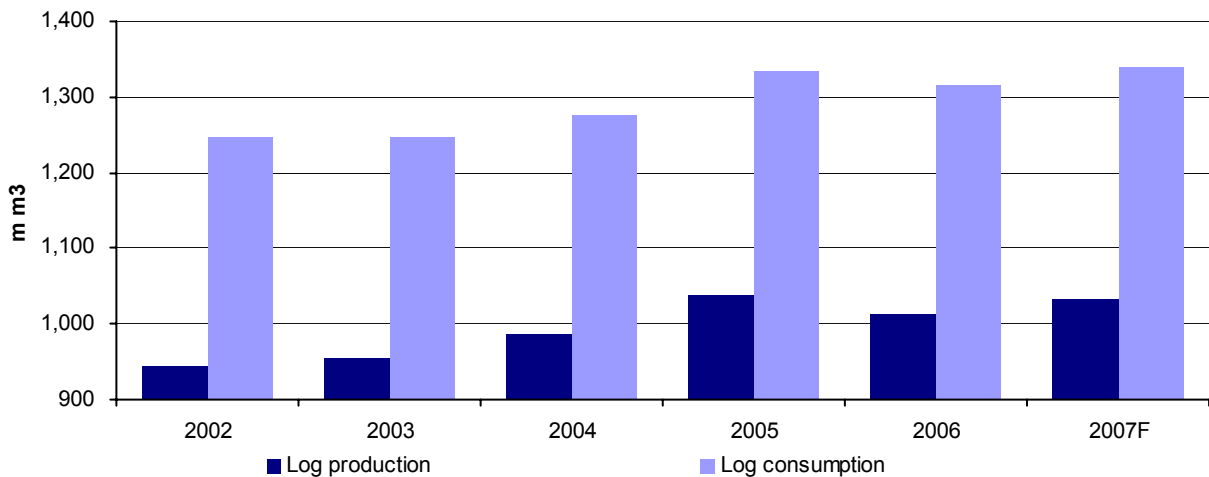
Source: International Rubber Study Group

Strong demand from China. China is the world's largest rubber consumer. In 3Q06, it accounted for 27.3% of the world's total rubber consumption, according to the Association Of Natural Rubber Producing Countries. In 2006, gross revenue of China rubber-related industries increased 22.7% YoY to RMB38.5b. The country produced 189.0m tires in 2006, up 11.4% YoY. Revenue of China's rubber tube and film sector, rubber shoe sector and GRG sector increased 43.6% YoY, 13.3% YoY and 29.1% YoY, respectively. Between 1996 and 2005, China's natural rubber consumption increased at a nine-year CAGR of 11.1% to 2.3m tons driven by the country's strong economic

growth, increasing affluence and rapid industrialization. The China Rubber Industry Association projected that between 2007 and 2010, China's rubber consumption will increase by more than 10.0% per annum.

Log shortage. According to the International Tropical Timber Organization (ITTO), the total log production of its members increased at a four-year CAGR of 1.8% and their total log consumption 1.4% between 2002 and 2006. Although the supply growth rate exceeds the demand growth rate, the actual production volume has been barely able to keep up with consumption. The total log production 4,941.1m m³ in 2002-2006 failed to satisfy the total log consumption of 6,414.9m m³, and the deficit was filled by imports, which in the period increased at a four-year CAGR of 0.2%, while exports decreased at a four-year compound annual rate of 1.5%. The supply and demand situation in the global log market is expected to remain tight, with production increasing 1.7% YoY to 1,032.1m m³ this year and demand 1.8% YoY to 1,339.5m m³. As such, log prices are expected to remain strong.

Chart 3: ITTO's members log production and consumption



Source: ITTO

Deforestation. Forests are unevenly distributed across the world. In developed countries forest areas have stabilized and are generally increasing at a modest rate each year. However, deforestation remains a major issue in developing countries, particularly in tropical and sub-tropical regions. In all three ITTO producer regions, forest coverage has been declining since the inception of ITTO: in Africa, from 49.3% of the total land area in 1985 to 44.2% in 2005; in Asia, from 41.4% to 35.4%; and in Latin America from 59.4% to 52.4%. For all ITTO producer countries as a whole, the decline was from 52.7% in 1985 to 46.4% in 2005.

Deforestation in Cambodia. Forests are Cambodia's most valuable resource. Global Witness, a UK-based environmental group, estimates that over the last 30 years Cambodia's forest coverage declined from 70.0% to 30.0%. The government has attempted to regulate forest exploitation, but with limited success.

China's wood appetite. China has become the world's largest exporter of forest products in value terms. Its own forests meet only a small fraction of its industrial roundwood demand and the country has to rely on imports to meet the shortfall. Years of fixed assets investments in mills and transportation have led to a huge expansion in wood processing and forest product manufacturing industries, especially furniture, millwork and mouldings. Over the last decade, China's furniture exports have grown at an annual rate of 34.0% and currently account for 43.0% of the US' wood furniture imports and 33.0% of Europe's. China is also the world's second largest forest product supplier after Canada. Although exports are rising, domestic consumption is also increasing as living standards rise.

World's largest log importer. According ITTO, China is the world's largest importer of tropical logs, importing more than 7.3m m³ in 2005 and 6.8m m³ in 2006. Its 2007 imports are estimated at 6.5m m³. The country's non-tropical logs come mainly from Russia. China's total log imports reached 31m m³ in 2006, exceeding by far those of all other countries, and are expected to reach about 33.0m m³ in 2007.

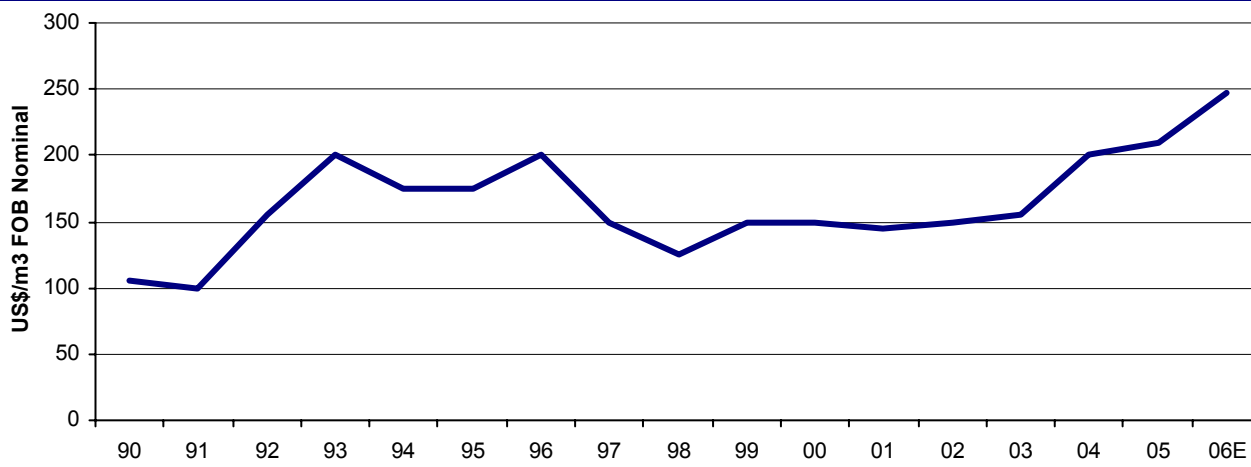
Supply shock in softwood market. Russia, with more than 20.0% of the world's timber resources, is the main exporter of softwood logs (about 40.0% of the global total), supplying about 70.0% of China's needs. In February 2007, Russia announced plans to raise tariffs over the next two years to 20.0% (but not less than EUR10.0 per m³) by July 2007, 25.0% (but not less than EUR15.0 per m³) by April 2008 and 80.0% (but not less than EUR50.0 per m³) by January 2009. Its government's plan to expand the domestic wood processing industry and reduce log exports will reduce the world's log supply; especially softwood logs, driving global log prices.

Illegal logging. This is a major factor depressing wood prices. For example, in Indonesia, the world's second largest tropical log producer in 2005, illegal logging is estimated to account for 40-80% of the total wood supply.

The Indonesian government has recently re-introduced an export ban on all ramin except a limited quantity of certified wood exported by one company. Malaysia also introduced legislation banning the import of logs and squared timber from Indonesia in response to Indonesia’s export ban. The Indonesian government also signed bilateral agreements with several importing countries including China, Japan and the UK to help curb illegal logging. Since the reintroduction of the export ban and tighter controls on illegal trade, Indonesia’s tropical log exports declined from 646,000 m³ in 2002 to 100,000 m³ 2003, according to ITTO. ITTO statistics show that Indonesia’s tropical log exports remained at 100,000 m³ in 2004, with no tropical log exports in 2005. In the long term, such measures will help support wood prices.

Log price trend. Tropical hardwood prices peaked in the mid-1990s and declined significantly during the Asian financial crisis in 1997 and 1998. Since 2000, especially over the last three years, log prices have been rising. Between 2002 and 2005, the price of meranti (high quality grade log) increased at a three-year CAGR of 11.7%, boosted by strong demand from China. Asia’s positive economic growth, increasing urbanization and expanding furniture, construction and interior decoration industries should drive demand for logs and wood products, including tropical hardwoods

Chart 4: Meranti log price trend (US\$/m3)



Source: Bloomberg

Political environment in Cambodia. Cambodia is a constitutional monarchy and its constitution provides for a multiparty democracy. It is run by a coalition government comprising the Cambodia People’s Party (CPP), the dominant partner and the National United Front for an Independent, Neutral, Peaceful and Co-operative Cambodia (FUNCINPEC).

Government structure. The monarch is the head of state and responsible for appointing the prime minister. The cabinet is chosen by the prime minister with the king’s approval. However, the influence of the monarchy has declined in recent years, as the successor of Norodom Sihamoni who stepped down in 2004, King Sihamoni has been remain politically neutral. The executive branch dominates the legislature and the judiciary. The legislature comprises the 123-seat National Assembly (the lower house) and the 61-seat Senate (the upper house), both of which are dominated by the CPP. Thus, the parliamentary agenda is largely driven and controlled by the CPP executive. Judges are also highly vulnerable to political pressure. Parliament cannot be dissolved before the expiry of its five-year term unless the government has been dismissed twice within twelve months. The five-year term can be extended by one year at a time if there is a threat to national security, on the recommendation of the king and with the approval of two-third of National Assembly. Constitutional changes require the support of a two-thirds majority. Policymaking is highly centralized around the executive branch of the government.

Terms of prime minister. The prime minister is appointed by the National Assembly every five years following the national elections. There is no constitutional or legal restriction on how long a prime minister can serve in the office. The next National Assembly elections are expected to be held in July 2008.

CPP is in power. Of the 23 political parties competing in the July 2003 National Assembly election, only three, the CPP, FUNCINPEC and SRP won seats. With 73 out of 123 seats in the National Assembly and 45 out of 61 seats in Senate, the CPP is politically dominant. According to preliminary results of the April 2007 commune council election, the CPP won 60.0% of the total vote. The party also dominates nearly all of the country’s 1,621 commune councils. The president of the Senate, Chea Sim, is the chairman of the CPP; the prime minister of Cambodia, Hun Sen is the party’s deputy chairman. The party’s honorary chairman, Heng Samrin, became the National Assembly chairman in March 2006. CPP can be regarded as pragmatic reformist. It tends to support market reforms when it accords with its political requirements or it has no choice as a results of international agreements. It is expected that

the party will win the general election in 2008 and form the first single-party government since the current era of parliamentary democracy began.

Donor nation. The government has managed to gain the broad support of multilateral and bilateral donors, primary because it continues to move in a market-oriented direction. In March 2006, the government hosted the eighth Consultative Group meeting, bringing together donors from 18 countries and five international organizations. Despite ongoing concerns over the government's failure to make solid progress in tackling corruption, donors remain content with its policy performance.

Close relationship with China. Political ties between China and Cambodia have been strengthened since 1997. In 2000, China's president Jiang Zemin became the first Chinese head of state to visit Cambodia, and his trip was followed by National People Congress Chairman Li Peng in 2001 and Premier Zhu Rongji in 2002. In April 2006, China's current Premier Wen Jiabao visited Cambodia. Cambodia's prime minister has become a frequent visitor to China since 1997. King Norodom Sihamoni's first overseas trip as head of state was to China in August in 2005. China has been a major donor providing about US\$610.0m to Cambodia in investments, grants, and aid between 1997 and 2000. In April 2006, it pledged another US\$600.0m. While Western countries, Japan and international agencies are still important donors, collectively pledging US\$601.0m in 2006, they often attach conditions (such as demands for judicial and political reforms or corruption crackdown). China's donations and aid come without any conditions and cover a range of issues, such as combating transnational crime, health cooperation, Internet services, protecting Angkor Wat temples and establishing a national botanical garden. In return, Hun Sen's government has supported China on the international arena. In May 1999, it condemned NATO's accidental bombing of the Chinese Embassy in Belgrade, in April 2001 it offered assistance during the EP-3 reconnaissance plane incident and in 2002 it refused a visa to the Dalai Lama and clamped down on the activities of the Falun Gong spiritual movement.

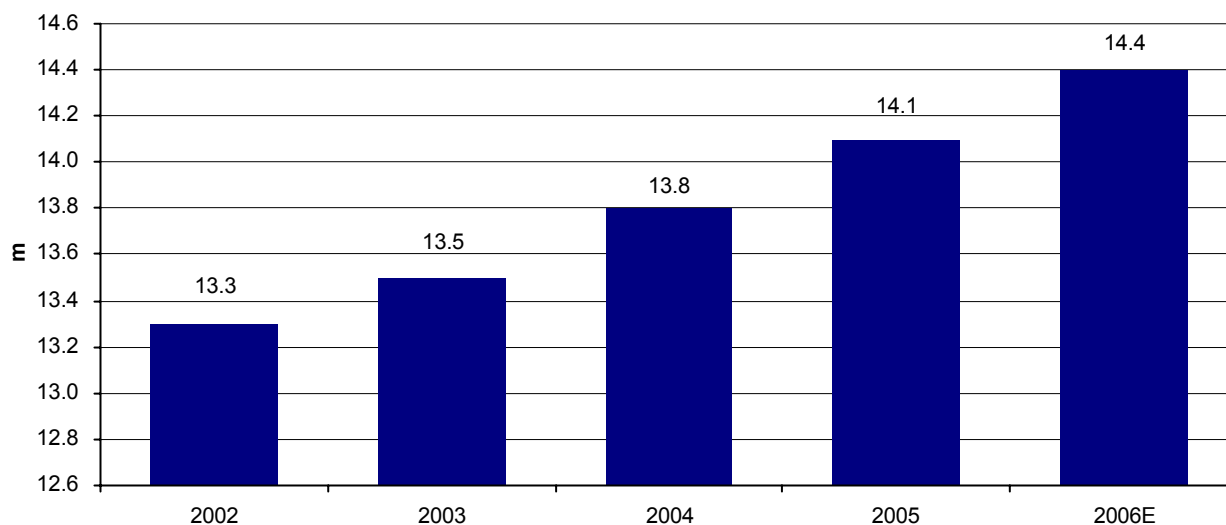
Robust bilateral trade. China's direct investment in Cambodia increased at a two-year CAGR of 124.4% from US\$89.0m in 2004 to US\$448.0m in 2006, making it the biggest foreign direct investor in the country. China is also one of Cambodia's main trade partners. Between 1992 and 2005, the value of their bilateral trade increased at a 13-year CAGR of 33.7%, to US\$563.3m from US\$13.0m. The two countries aim to boost two-way trade from US\$500.0m to US\$1.0b by 2010. China provides preferential tariff treatment for 418 Cambodian products.

WTO and ASEAN membership. Cambodia gained the full membership of Association of South-East Asian Nations (ASEAN) in April 1999. It is one of the four less-developed ASEAN members together with Laos (L), Myanmar (M) and Vietnam (V), commonly known as CLMV. The group held their first leadership summit in Vientiane, Laos, in November 2004, ahead of the full ASEAN leadership summit. It agreed to strengthen its coordination, mutual assistance and economic co-operation and its leaders signed the Vientiane Declaration on Enhancing Economic Co-operation and Integration. After Cambodia's accession to the World Trade Organization (WTO) in late 2004, the government has been pushing through new and amended legislation to fulfill its commitments to the global trading body. However, the government's labor reform, which includes measures to reduce night-shift wages, has triggered opposition from labor unions.

Investor-friendly environment. In terms of economic freedom, Cambodia was ranked 35 in 2005, same as Japan. The government offers the Generalized System of Preferences (GSP) to investors, especially foreign investors, and privileges to textile and garment manufacturers include flexible export quotas and import tariff exemption. The favorable operating environment has attracted Chinese textile and garment manufacturers to Cambodia. According to estimates, 80.0% of Cambodia's garment and textile manufacturing plants are owned by Chinese entrepreneurs. According to the country's "Investment Law", foreign and domestic investors are equal, except in land ownership. The government also pledged not to regulate prices/tariffs of approved projects. With no forex controls, foreign investors can purchase foreign currencies in banks and transfer them abroad. They can lease land for 99 years, with an option to extend upon expiry. To encourage foreign direct investment, production equipment, construction materials, components and raw materials are exempt from import tariffs. Foreign enterprises also pay no corporate tax during the first three to eight years of their operation and are taxed at 9.0% afterwards. Earnings retained for reinvestment are also corporate tax exempt. Dividends are not subject to profit tax.

Population. According to the Economist Intelligence Unit, Cambodia's population increased at a four-year CAGR of 2.0% to 14.4m in 2006 from 13.3m in 2002. In 2004, about 37.7% of the population was under the age of 15, 58.9% was aged 15-64 and the rest was aged above 65. According to the United Nation Development Programme (UNDP), around 19.0% of the population lives in urban areas. Phnom Penh is the capital city with about 1.0m inhabitants. The country's national population density was estimated at 64 people per sq km in 1998, with the rate at 161 people per sq km in central provinces. About 90.0% of the population is ethnic Khmer. Other major groups include the Vietnamese (0.5m) and Chinese (0.6m).

Chart 5: Population



Source: company data

Skilled labour shortage. According to UNDP data, the adult literacy rate in Cambodia increased to 73.6% in 2003 from 62.0% in 1990, still below that of Thailand (92.6%) and Vietnam (90.3%). The primary school enrolment rate has increased to 98.0% in 2003 from 69.0% in 1991 but secondary school enrollment stood at only 26.0% in 2004. Tertiary education opportunities are inadequate. As a result, there is a shortage of skilled labour in Cambodia.

Rich in natural resources. Except timber, Cambodia has rich fish stocks. It has modest but commercially viable deposits of phosphate, granite, limestone, sand, gravel, clay and bauxite, and some gold and gem reserves. With increasing exploration activities in the country in recent years, large reserves of oil and gas have been found in the Gulf of Thailand.

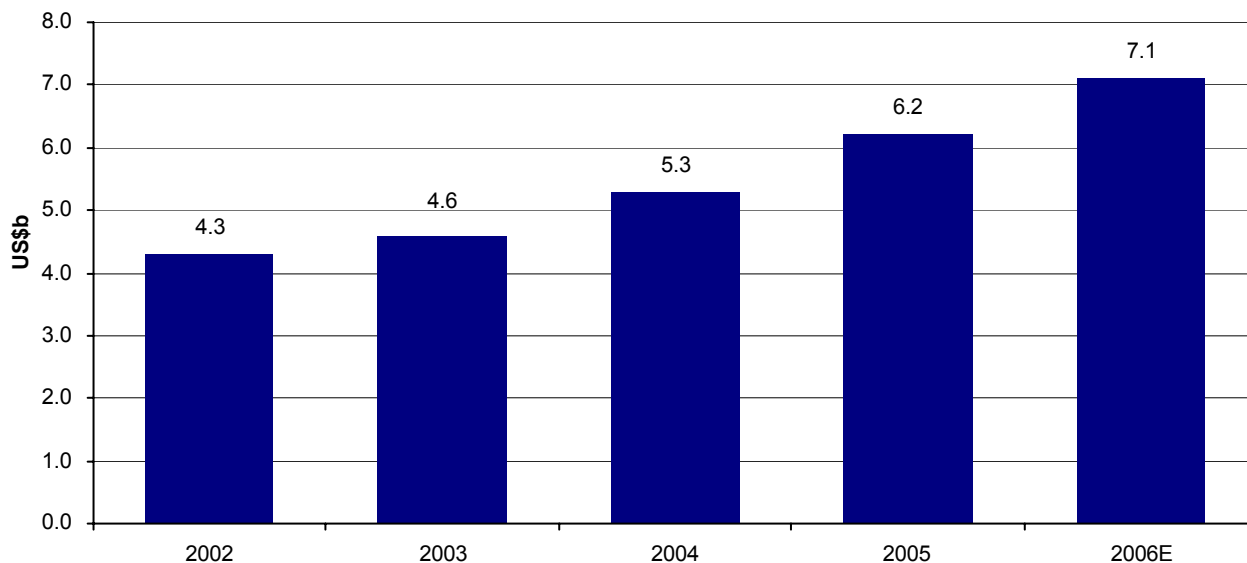
Transportation infrastructure. According to the World Bank, Cambodia had about 4,800 km of national roads, 5,700 km of regional roads and 27,800 km of rural roads. Only 28.0% of national roads were paved in 2003. Inland waterways act as important transport routes. The major routes are the Mekong and Tonle Sap rivers. The railway system comprises a 385-km line running from Phnom Penh to Poipet on the Thai border, which is in urgent need of repair, and a 263-km route from Phnom Penh to Sihanoukville, which was upgraded in 1996. Cambodia has eight airports including two main airports (Phnom Penh and Siem Reap) operating international flights. The country has two major ports - river port in Phnom Penh on the Mekong and a deepwater seaport in Sihanoukville.

Transport improvements. Foreign donors are financing a wide range of road and bridge projects. In December 2006, the Asian Development Bank (ADB) said it would provide a US\$42.0m loan under the Great Mekong Sub-region Programme to help rebuild the lines of the railway system from Phnom Penh and Poipet by end-2009. The OPEC Fund for International Development and the Malaysian government will also contribute. The Cambodian government will fund its share of the project, lead by the Ministry of Public Works and Transportation. Japan is supporting the upgrade and expansion of the Sihanoukville port, with the most recent deal agreed on in September 2004.

Telecom and power generation. Cambodia's installed capacity stood at 187.0MW in 2003, with around 85.0% coming from diesel-fuelled generators and the rest from hydroelectric sources or imported batteries. According to the World Bank, only 17.0% of households in the country have electricity supply. The capital city, Phnom Penh, consumes 85.0% of the total power produced. All diesel used for power generation has to be imported. In 2003, Cambodia had only 0.3 fixed telephone lines per 100 people, compared with 5.4 in Vietnam and 10.5 in Thailand, according to the World Bank. In late 2005, total number of fixed lines was about 40,000. Due to the inadequate fixed-line system, mobile phones are popular and the number of mobile subscribers exceeded 1.0m in late 2005.

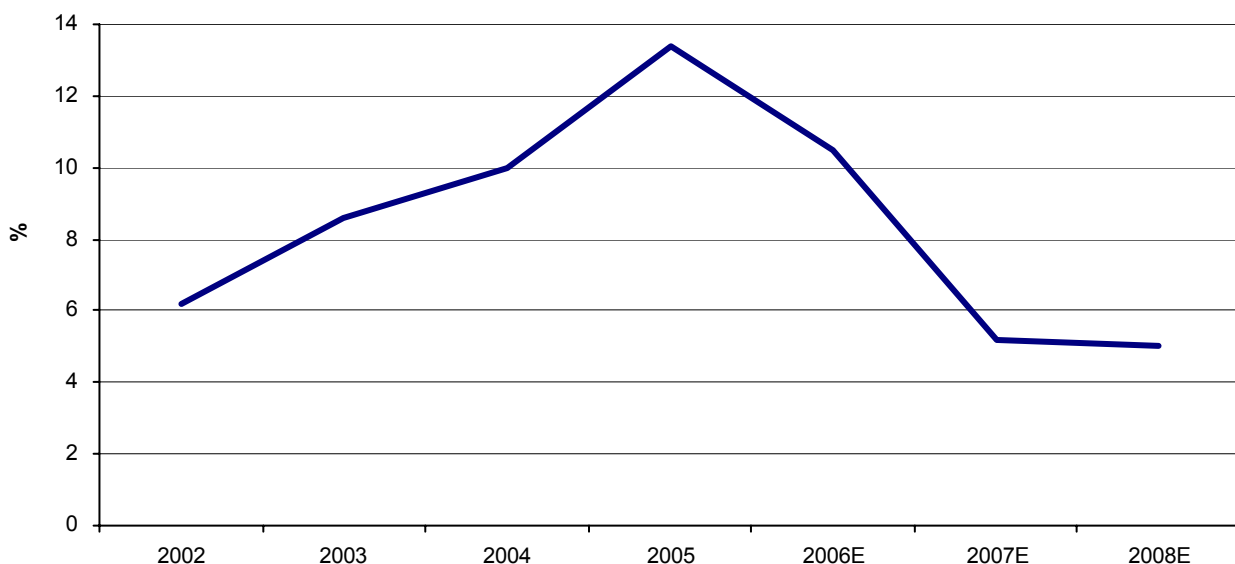
Economic outlook. Between 2002 and 2006, Cambodia's GDP increased at a four-year CAGR of 13.4%, from US\$4.3b to US\$7.1b. Its real GDP growth rate decelerated to 10.5% in 2006 from 13.4% in 2005. Agriculture and services were the major sources of GDP in 2005, accounting for 34.2% and 39.1% of the total. Inflation peaked at 5.8% in 2005 and retreated to 4.7% in 2006. The Economist Intelligence Unit projected that the country's GDP growth will decelerate to 5.2% in 2007 and 5.0% in 2008, due to: 1) low efficiency of the garment manufacturing sector; 2) uncertainties in the expansion of tourism; 3) uncertain weather conditions affecting primary sector output; 4) import growth outpacing net exports; 5) rising rice prices boosting consumption in rural areas.

Chart 6: Cambodia's GDP



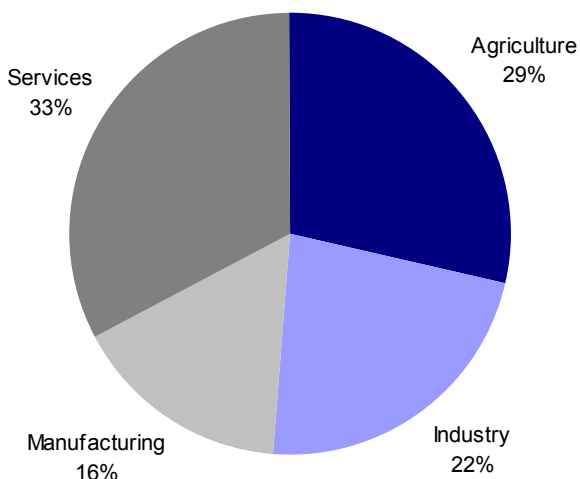
Source: Economist Intelligence Unit

Chart 7: Cambodia's real GDP growth



Source: Economist Intelligence Unit

Chart 8: Origins of Cambodia's GDP 2005



Source: Economist Intelligence Unit

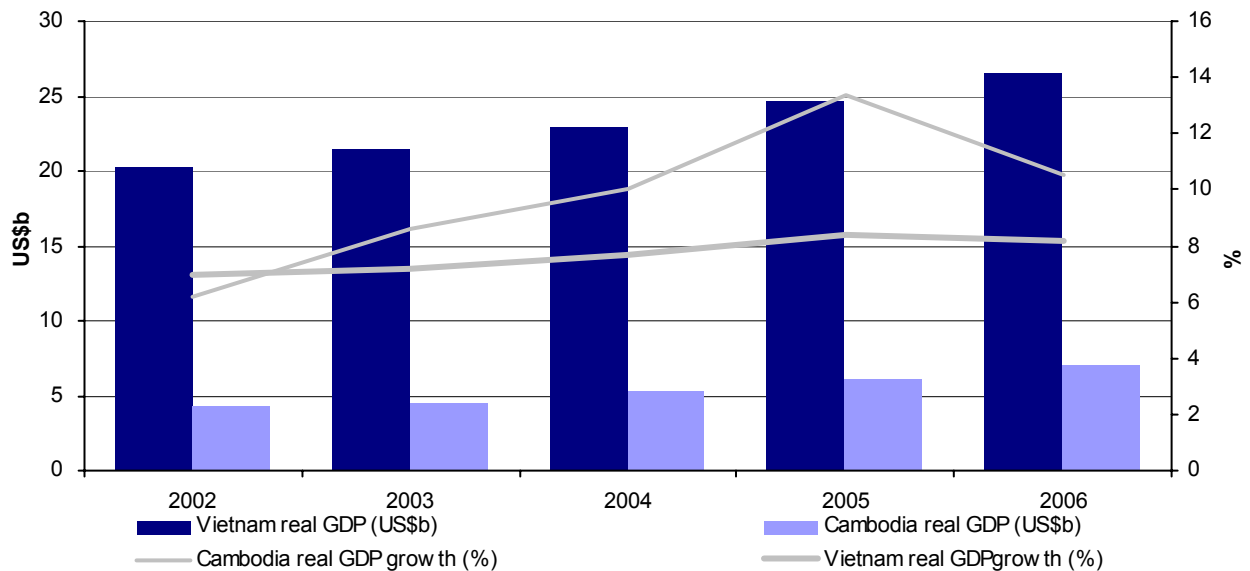
Investment opportunities. Vietnam’s real GDP amounted to US\$26.5b in 2006, 4.0x the size of Cambodia’s, but its four-year CAGR between 2002 and 2006 was 6.9% compared with Cambodia’s 13.4%. Since the start of market reforms in 1985, Vietnam’s economy has been growing rapidly but comparatively, Cambodia has a much higher growth potential. Its long history of warfare, the destruction of its economic and social fabric under Khmer Rouge (1975-1979) and central planning have seriously damaged the country’s economy and development. With the current relatively stable political environment, Cambodia is set to grow again and benefit from the resources boom started in 2003. Low labor costs make it one of the region’s most competitive manufacturing bases. Though living standards are still below the world’s average, incomes are rising and a consumption boom is inevitable. In conclusion, still underdeveloped, Cambodia presents some of the best investment opportunities in Southeast Asia.

Table 9: Comparative economic indicators for 2006

	Cambodia	Thailand	Vietnam	Myanmar	Malaysia
GDP (US\$b)	6.8	206.2	60.7	9.1	148.9
GDP/capita (US\$)	476.0	3,125.0	715.0	178.0	5,591.0
Inflation rate (%)	4.8	4.6	7.6	16.3	3.6
Export of goods FOB (US\$b)	3.4	128.2	39.7	5.6	160.0
Import of goods FOB (US\$b)	(4.5)	(113.4)	(40.0)	(2.1)	(125.7)

Source: Economist Intelligence Unit

Chart 9: Economic growth - Vietnam and Cambodia



Source: Economist Intelligence Unit, Bloomberg

P & L (HK\$m)	04A	05A	06A	Cash Flow (HK\$m)	04A	05A	06A
Year to Dec				Year to Dec			
Turnover	31.6	36.1	35.0	EBIT	4.6	(3.6)	(27.7)
% chg	7.5	14.3	(3.1)	Depre./amort.	8.1	5.5	1.6
Gross profit	15.8	20.8	(12.0)	Net int. paid	1.5	1.3	0.9
EBITDA	12.7	1.9	(26.1)	Tax paid	-	-	-
Depre./amort.	(8.1)	(5.5)	(1.6)	Dividends received	-	-	-
EBIT	4.6	(3.6)	(27.7)	Gross cashflow	14.2	3.2	(25.1)
Net int. income/(exp.)	1.5	1.3	0.9	Chgs. in working cap.	(35.4)	(44.2)	1.9
Exceptionals	-	-	-	Operating cashflow	(21.2)	(41.0)	(23.2)
Associates	(0.3)	-	-	Capex	(2.7)	(2.7)	(7.8)
Jointly-controlled entit.	-	-	-	Free cashflow	(23.9)	(43.7)	(31.0)
Pre-tax profit	5.8	(2.3)	(26.7)	Dividends paid	-	-	-
Tax	(2.5)	-	(0.2)	Net distribution to MI	-	-	-
Minority interests	0.3	0.1	(2.4)	Investments	-	-	-
Net profit	3.6	(2.2)	(29.4)	Disposals	-	0.1	-
% chg	-	-	-	New shares	-	-	-
Dividends	-	-	-	Others	34.4	9.1	33.6
Retained earnings	3.6	(2.2)	(29.4)	Net cashflow	10.5	(34.5)	2.5
EPS (HK\$) - Basic	0.004	(0.003)	(0.035)	Net (debt)/cash - Beg.	87.9	98.4	63.9
EPS (HK\$) - F.D.	0.004	(0.003)	(0.035)	Net (debt)/cash - End.	98.4	63.9	66.5
DPS (HK\$)	-	-	-				
No. sh.s o/s (m) - W.A.	835.0	835.0	835.0	Interim Results (HK\$m)	05A	06A	
No. sh.s o/s (m) - Y.E.	835.0	835.0	835.0	Six months to Jun			
No. sh.s o/s (m) - F.D.	835.0	835.0	835.0	Turnover	12.5	16.9	
				% chg	(28.2)	34.8	
Margins (%)				Profit from operations	(2.6)	1.2	
Gross	50.1	57.6	(34.3)	Interest expenses	(0.1)	(0.1)	
EBITDA	40.3	5.2	(74.5)	Associates	-	-	
EBIT	14.5	(9.9)	(79.1)	Jointly-controlled entit.	-	-	
Pre-tax	18.3	(6.4)	(76.5)	Pre-tax profit	(2.7)	1.1	
Net	11.3	(6.0)	(84.0)	Tax	(0.6)	-	
				Minority interests	0.4	(0.9)	
				Net profit	(2.9)	0.2	
				% chg	-	-	
				EPS (HK\$) - Basic	(0.0)	0.0	
				DPS (HK\$)	-	-	
				Shareholding Structure			
					Shares o/s (m)	%	
				PME	212.3	25.4	
				China Equity Associates L.P.	84.0	10.1	
				Public	538.6	64.5	
				Total	835.0	100.0	
				Background			
				Listed on the GEM board of HKEX in December 2001, Medical China is principally engaged in the research, development and provision of medical devices for cancer treatment, including RFAS and 3-dimensional laparoscope. It also promotes anticancer drugs in China and manufactures and sells medical testing equipment in the mainland and overseas. The group plans to acquire from shareholders of the (Cambodia) Tong Min a 100.0% interest in the 70-year concession of natural forest in Cambodia granted by the Cambodian government.			
				Key Ratios	04A	05A	06A
				Net gearing (%)	81.7	52.3	59.1
				Net ROE (%)	3.1	(1.8)	(27.3)
				EBIT ROCE (%)	3.7	(2.9)	(23.8)
				Dividend payout (%)	-	-	-
				Effective tax rate (%)	43.4	-	(0.8)
				Net interest coverage (x)	na	2.8	29.6
				A/R turnover (days)	76.7	98.7	131.9
				A/P turnover (days)	757.8	474.9	304.7
				Stock turnover (days)	164.3	156.7	43.8
Balance Sheet (HK\$m)	04A	05A	06A				
Year to Dec							
Fixed assets	20.6	11.9	18.9				
Intangible assets	55.1	58.0	28.1				
Other LT assets	-	-	-				
Cash	100.3	68.3	70.0				
Accounts receivable	6.6	12.9	12.4				
Other receivables	-	-	-				
Inventories	7.1	6.0	5.2				
Due from related co.s	-	-	-				
Other current assets	-	-	-				
Total assets	189.7	157.1	134.6				
Accounts payable	(65.6)	(28.3)	(30.1)				
Other payable	-	-	-				
Tax payable	(0.0)	(0.0)	(0.2)				
Due to related co.s	(1.8)	(0.2)	-				
ST debts	(1.9)	(4.3)	(3.5)				
Other current liab.	-	-	-				
LT debts	-	-	-				
Other LT liabilities	-	-	-				
Total liabilities	(69.3)	(32.9)	(33.8)				
Share capital	8.4	8.4	8.4				
Reserves	108.4	112.1	86.1				
Shareholders' funds	116.7	120.5	94.4				
Minority interest	3.8	3.7	6.3				
Total	120.5	124.2	100.8				
Capital employed	122.4	128.5	104.2				
Net (debt)/cash	98.4	63.9	66.5				