

Medical China: Harvest time

Recommendation: STRONG BUY (unchanged)

Asia Resources

Price	HK\$0.53	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$2.09 (+260.3%)	Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$0.03-0.98	05A	(2.2)	(0.003)	na	na	4.0	382.0	na	(1.8)	na	Cash
Market cap.	US\$62.1m	06A	(29.4)	(0.035)	na	na	5.1	na	na	(27.3)	na	Cash
Daily t/o, 3 mth	US\$2.9m	07F	(6.2)	(0.005)	na	na	4.0	na	na	(3.7)	na	Cash
Free float %	68.7%	08F	249.4	0.146	na	4.0	2.0	2.9	na	67.6	43.2	Cash
Ticker	8186.HK/8186 HK	09F	341.6	0.200	36.9	2.9	1.2	2.2	na	50.9	37.2	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +6.8%, -2.8%, +969.5%

Actual price changes (1 mth, 3 mth, 12 mth): +28.9%, +13.7%, +1,426.3%

Previous forecasts (08F-09F): HK\$246.6m (\$0.145), HK\$343.0m (\$0.201)

Key points:

- Soon to be renamed as China Asean Resources.
- Has received relevant approvals from the government.
- Acquisition to be concluded at the beginning of October.
- Three new acquisition targets identified.
- Vendors confident in earnings outlook.
- Undervalued superior-quality asset.
- STRONG BUY reiterated, target price at HK\$2.09, with an upside potential of 260.3%

Concession rights deal. (Cambodia) Tong Min is a private limited liability company incorporated in Cambodia on 20 March 2007, registered in Phnom, Penh. Its issued share capital is 70.0% owned by Mr. Zhang Zhenzhong (first vendor), 10.0% by Mr. Pen Sophal (second vendor) and 20.0% by Ms. Zhang Jie (third vendor). The company plans to set up and operate a rubber plantation to make latex under exclusive exploitation rights for 70 years. Responsible for clearing the forest, it expects to be granted the right to process and sell residual timber as well as processing it into sawn timber and other high value-added wood products such as flooring.

Green light for the project. The Office of Prime Minister of Cambodia and the relevant Cambodian provincial government have granted to (Cambodia) Tong Min land use rights for a rubber plantation covering 9,965.0 hectares. After the completion of certain documentation procedures, (Cambodia) Tong Min is expected to receive formal forest exploitation rights from the Ministry of Agriculture, Forestry and Fisheries (MAFF) soon.

Structure. The aggregate consideration of the acquisition is HK\$208.4m. As the major shareholder of (Cambodia) Tong Min, Mr Zhang will receive HK\$50.0m in cash and HK\$70.0m in straight bonds. Mr. Pen Sophal and Ms Zhang Jie will receive 400.0m shares and a convertible bond with a face value of HK\$13.2m at the conversion price of HK\$0.188, collectively.

More acquisitions in the pipeline. Under the deal, the vendors have granted the listco an option to acquire all the issued share capital of companies with the right to exploit forestry resources obtained by the vendors in the future. The vendors are currently in the process of acquiring three concession forests with an aggregate area of about 30,000.0 hectares (10,000.0 hectares each), which when the deal is finalized, can be immediately passed onto the listco. Upon the exercise of the option, the listco shall pay HK\$30.0m in cash to Mr. Zhang Zhenzhong. No more call option premiums will be payable by the listco to Mr. Zhang upon any further exercise of the option. If the listco obtains the three concessions and turns the forests into rubber plantations, we expect it to become a leading rubber plantation operator in Cambodia, occupying 26.6% of the country's total rubber plantation area.

Profit guarantee and compensation mechanism. Pursuant to the acquisition agreement between China Asean Resources (listco) and the vendors, the vendors guaranteed that the audited net profit for FY12/08F would be no less than HK\$170.0m and that aggregate net profit between FY12/09F and FY12/11F would be no less than HK\$700.0m (no less than HK\$233.3m each fiscal year). The second and third vendor have undertaken to the

listco that should the actual profit for FY12/08F or the FY12/09F and FY12/11F period fall below 70.0% of the respective guaranteed profits, they will compensate the listco by (either or both): 1) selling their shares of the listco at the open market and compensating the listco with the proceeds. The calculation of the number of compensation shares will be based on the deficit divided by the average closing prices for the five trading days immediately before the date of the publication of the group's results. The vendors can only sell up to 30.0% (141.0m shares) and 20.0% (94.0m shares) of their holdings (including conversion shares yet to be converted) as compensation for FY12/08F and the FY12/09F and FY12/11F period, respectively; 2) redeeming part or all of the outstanding convertible notes (the CBs with face value of HK\$13.16m and conversion price of HK\$0.188 each) by the group at HK\$1.0. Should the second and third vendor fail to fulfill their obligations, the listco has the right to seek compensation from the first vendor. In our view, the compensation mechanism ensures that the two vendors help maximize the company's profitability.

First concessionary forest. The valuation of the concession was conducted by Hong Kong-based BMI Appraisals and the technical appraisal by The Research Institute of Tropical Forestry, the Chinese Academy of Forestry. Under the concession deal, (Cambodia) Tong Min has the right to exploit the forest in Kratie province with an area of 9,965.0 hectares (or 99.65m sq.m) for 70 years. Kratie is about 370.0km away from the capital Phnom Penh, linked by national Highway No.6 and National Highway No.7, and about 25.0km from the River Tonle Mekong, the major river in Cambodia. According to the technical report, the total timber stock of the forest is about 3.2m m³ with special timber representing 5.3% of the total, first-class timber 43.1% and general timber the rest. Special timber refers to the species such as Pterocarpus. First-class timber and general timber refer to the species like Dipterocarpaceae and Lythraceae, respectively. BMI Appraisals adopted the DCF approach to evaluate the concessionary forest and arrived at a valuation of US\$360.0m, or US\$35,707.2/hectare.

Strong government links. To strengthen its position in the exploitation of Cambodia's natural resources and pave the way for future acquisitions, (Cambodia) Tong Min has established an honorary advisory board and a forestry consultation board, comprising various experts and Cambodian government officials. Members of the honorary advisory board include: 1) Mr. Tol Chao, a "Three-Star" general in the Cambodian army, as well the deputy chief of cabinet to the prime minister of Cambodia, who is also the first deputy commander of the prime minister's body guard unit and the head of the National Forest Guard of Cambodia; 2) Mr. Kim Hong Mak is an advisor to the prime minister of Cambodia and the president of the Association of Rubber Development of Cambodia as well as a board member of the Cambodia Rubber Research Institute and the President of the Board of the Royal University of Agriculture in Cambodia. Members of the Forestry Consultation Board include: 1) Mr. Pheng Muthavy, deputy head of the Department of Rubber Development of Cambodia; 2) Mr. Li Guan Wu, head of the Central South Forestry Geotechnical Planning and Design Institute in China and 3) Mr. Zhang Ren, a qualified logging engineer working with the Heilongjiang Yichun Forestry Bureau.

Road map to the forest. The provincial government has already granted the land use rights of the concessionary forest to (Cambodia) Tong Min and the Office of Prime Minister of Cambodia and relevant government bodies of Cambodia have granted land use rights for a rubber plantation in the concessionary forest. The listco will hold a special general meeting on 2 October 2007 to resolve the following issues: 1) renaming the listco, currently called Medical China, as China Asean Resources; 2) increasing the authorized share capital from 2.0b at HK\$0.01 each to 5.0b at HK\$0.01 each; 3) approving the acquisition of (Cambodia) Tong Min. In our view, the listco needs to expand its fund raising capability for future acquisitions.

Cheap high-quality asset. Based on the acquisition price of HK\$208.4m and the estimated forest timber stock volume in the concessionary forest of 3.2m m³, we estimate the value per m³ of log in (Cambodia) Tong Min's concessionary forest at US\$8.3, or HK\$64.8, substantially lower than the valuation of recent forestry transactions in the Hong Kong market. CH Grand Forest (910 HK, HK\$2.48, NR) has announced its plans to acquire three forests in Guangxi Zhuang Autonomous Region, Guizhou Province and Hunan Province for RMB111.9m, RMB156.8m and RMB118.3m, respectively. Valuations per m³ of log of their previous transactions are estimated at HK\$175.4/m³, HK\$208.0/m³ and HK\$153.0/m³, respectively. China Timber (269 HK, HK\$0.30, NR) acquired in September 2006 a 51.0% stake in Jailing Forest Industries, which owns rights to occupy and harvest timber in a forest in Guyana for 25 years, for HK\$154.0m, representing a valuation/m³ of HK\$107.8. In August 2007, China Timber announced plans to acquire another 44.0% in Jailing Forest Industries for HK\$130.0m, representing a valuation/m³ of HK\$105.5. The quality of (Cambodia) Tong Min's concessionary forest (density estimated at 322.6m³/hectare) is much higher than that of other forests. The density of CH Grand Forest's forest in Guangxi Zhuang, Guizhou and Hunan is 66.0m³/hectare, 43.2m³/hectare, and 97.6m³/hectare, respectively, and in Guyana at 17.0m³/hectare.

Table 1: Valuations of recent forestry transactions in HK market

Company name	Assets to be acquired	Area (hectares)	Timber stock volume (m m ³)	Valuation (HK\$m)	Value/m ³ (HK\$)	Density (m ³ /hectare)
CH Grand Forest	Forest in Guangxi Zhuang	9,998.7	0.7	115.8	175.4	66.0
	Forest in Guizhou	18,062.5	0.8	162.3	208.0	43.2
	Forest in Hunan	8,195.5	0.8	122.4	153.0	97.6
China Timber	51.0% interests in forest in Guyana	84,048.0	1.4	154.0	107.8	17.0
	44.0% interests in forest in Guyana	72,512.0	1.2	130.0	105.5	17.0
(Cambodia) Tong Min	100.0% interests in forest in Cambodia	10,082.0	3.2	208.4	64.8	322.6

Sources: The companies, SBI E2 Capital

Potential upside 260.3%. Based on the capex plan provided in the circular, we revise the group's earnings up by 1.1% to HK\$249.4m for FY12/08F and down by 0.4% to HK\$341.6m for FY12/09F, due to our modified capex and DD&A assumptions. Trading at a fully diluted P/E of 4.0x for FY12/08F and 2.9x for FY12/09F, the group's valuation is extremely attractive, compared with the sector's average one-year forward P/E of 22.8x and two-year forward P/E of 17.4x. Catalysts include earnings contributions from the concessionary forest and further acquisitions and assets injections. **STRONG BUY** reiterated with the target price kept at HK\$2.09, representing a FY12/08F P/E of 14.3x on a fully diluted basis.

Table 2: Peer group comparison

Company name	Ticker	Year End	Currency	Price	Market Cap (US\$m)	P/E (x)	
						1-yr forward	2-yr forward
Ta Ann Holdings	TAH MK	Dec	MYR	7.9	482.8	9.5	8.2
Jaya Tiasa Holdings	JT MK	Apr	MYR	3.7	299.6	18.0	6.0
WTK Holdings	WTKH MK	Dec	MYR	2.2	272.8	2.4	2.2
Lingui Development	LING MK	Jun	MYR	2.0	378.0	9.6	5.5
Evergreen Fibreboard	EVF MK	Dec	MYR	1.8	247.6	11.4	7.5
Timberwest Forest	TWF-U CN	Dec	CAD	15.4	1,162.1	17.0	9.7
International Forest Products	IFP/A CN	Dec	CAD	7.5	344.0	81.0	23.2
Sino-Forest	TRE CN	Dec	CAD	20.3	3,550.4	18.3	15.4
Weyerhaeuser	WY US	Dec	USD	69.4	15,097.4	38.8	24.9
International Paper	IP US	Dec	USD	34.9	15,002.8	15.8	13.4
Rayonier Inc	RYN US	Dec	USD	42.8	3,332.5	21.1	21.4
Pottlatch Corp	PCH US	Dec	USD	41.8	1,632.0	24.2	20.8
Plum Creek Timber	PCL US	Dec	USD	42.6	7,440.4	28.2	25.4
Fletcher Building	FBU NZ	Jun	NZD	12.1	4,299.6	14.2	13.2
Gunns Ltd	GNS AU	Jun	AUD	3.1	1,029.0	13.5	12.3
UPM-Kymmene Oyj	UPM1V FH	Dec	EUR	16.3	11,933.5	14.1	11.2
<i>Average</i>						22.8	17.4

Source: Bloomberg

Risk factors. 1) Commitment of the major owner of (Cambodia) Tong Min. It is noteworthy that Mr. Zhang Zhenzhong will take no shares as the consideration of the acquisition but cash of HK\$50.0m and straight bonds with a face value of HK\$70.0m instead. Compared with the other two stakeholders, Mr. Pen Sophal and Ms. Zhang Jie, who will take shares of the listco and convertible bonds that can be converted into the shares of listco, his commitment seems relatively low. We believe that Mr. Zhang will take a very active role in managing the project because after the acquisition, the listco will owe him HK\$70.0m and because he will be involved in arranging the acquisition of three new forests for the listco; 2) Share increase. If the compensation mechanism related to the profit guarantee is triggered, the supply of shares will increase. However, we expect the earnings for the FY12/08F and FY12/11F period to surpass the guaranteed profits.

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Sole Bookrunner and Joint Placing Agent for Medical China (233m Top-up shares and 167m new shares at HK\$0.60) on Jul, 2007.

P & L (HK\$m)	05A	06A	07F	08F	09F	Cash Flow (HK\$m)	05A	06A	07F	08F	09F
Year to Dec						Year to Dec					
Turnover	36.1	35.0	35.0	436.8	717.4	EBIT	(3.6)	(27.7)	(6.2)	240.8	323.5
% chg	14.3	(3.1)	0.1	1,147.9	64.3	Depre./amort.	5.5	1.6	1.5	2.9	4.4
Gross profit	20.8	20.9	1.2	275.0	408.3	Net int. paid	1.3	0.9	0.1	8.6	18.1
EBITDA	1.9	(26.1)	(4.7)	243.7	327.9	Tax paid	-	-	(0.2)	-	-
Depre./amort.	(5.5)	(1.6)	(1.5)	(2.9)	(4.4)	Dividends received	-	-	-	-	-
EBIT	(3.6)	(27.7)	(6.2)	240.8	323.5	Gross cashflow	3.2	(25.1)	(4.8)	252.3	346.0
Net int. income/(exp.)	1.3	0.9	0.1	8.6	18.1	Chgs. in working cap.	(44.2)	1.9	(14.5)	(2.5)	(6.5)
Exceptionals	-	-	-	-	-	Operating cashflow	(41.0)	(23.2)	(19.3)	249.8	339.5
Associates	-	-	-	-	-	Capex	(2.7)	(7.8)	(87.0)	(16.0)	-
Jointly-controlled entit.	-	-	-	-	-	Free cashflow	(43.7)	(31.0)	(106.3)	233.8	339.5
Pre-tax profit	(2.3)	(26.7)	(6.2)	249.4	341.6	Dividends paid	-	-	-	-	-
Tax	-	(0.2)	-	-	-	Net distribution to MI	-	-	-	-	-
Minority interests	0.1	(2.4)	-	-	-	Investments	-	-	-	-	-
Net profit	(2.2)	(29.4)	(6.2)	249.4	341.6	Disposals	0.1	-	-	-	-
% chg	-	-	-	-	36.9	New shares	-	-	232.8	-	-
Dividends	-	-	-	-	-	Others	9.1	33.6	(83.2)	13.2	-
Retained earnings	(2.2)	(29.4)	(6.2)	249.4	341.6	Net cashflow	(34.5)	2.5	43.3	247.0	339.5
EPS (HK\$) - Basic	(0.003)	(0.035)	(0.005)	0.146	0.200	Net (debt)/cash - Beg.	98.4	63.9	66.5	109.8	356.8
EPS (HK\$) - F.D.	(0.003)	(0.035)	(0.004)	0.146	0.200	Net (debt)/cash - End.	63.9	66.5	109.8	356.8	696.3
DPS (HK\$)	-	-	-	-	-	Interim Results (HK\$m)	05A	06A			
No. sh.s o/s (m) - W.A.	835.0	835.0	1,235.0	1,705.0	1,705.0	Six months to Jun					
No. sh.s o/s (m) - Y.E.	835.0	835.0	1,635.0	1,705.0	1,705.0	Turnover	12.5	16.9			
No. sh.s o/s (m) - F.D.	835.0	835.0	1,635.0	1,705.0	1,705.0	% chg	(28.2)	34.8			
Margins (%)						Profit from operations	(2.6)	1.2			
Gross	57.6	59.7	3.3	63.0	56.9	Interest expenses	(0.1)	(0.1)			
EBITDA	5.2	(74.5)	(13.5)	55.8	45.7	Associates	-	-			
EBIT	(9.9)	(79.1)	(17.8)	55.1	45.1	Jointly-controlled entit.	-	-			
Pre-tax	(6.4)	(76.5)	(17.6)	57.1	47.6	Pre-tax profit	(2.7)	1.1			
Net	(6.0)	(84.0)	(17.6)	57.1	47.6	Tax	(0.6)	-			
						Minority interests	0.4	(0.9)			
						Net profit	(2.9)	0.2			
						% chg	-	-			
						EPS (HK\$) - Basic	(0.003)	0.0002			
						DPS (HK\$)	-	-			
Balance Sheet (HK\$m)	05A	06A	07F	08F	09F	Shareholding Structure			Shares o/s (m)	%	
Year to Dec						Li Wo Hing			226.2	18.3	
Fixed assets	11.9	18.9	50.1	65.1	62.6	Li Nga To			32.8	2.7	
Intangible assets	58.0	28.1	82.4	80.4	78.5	UBS AG			66.7	5.4	
Other LT assets	-	-	-	-	-	Keywise			60.7	4.9	
Cash	68.3	70.0	192.9	426.8	766.3	Public			848.7	68.7	
Accounts receivable	12.9	12.4	2.8	34.9	57.4	Total			1,235.0	100.0	
Other receivables	-	-	-	-	-	Background					
Inventories	6.0	5.2	2.8	13.3	25.4	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 (Cambodia) Tong Min, which owns a 100.0% stake in the 70-year concession of natural forests in Cambodia granted by the Cambodian government.					
Due from related co.s	-	-	-	-	-	Key Ratios	05A	06A	07F	08F	09F
Other current assets	-	-	-	-	-	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Total assets	157.1	134.6	330.9	620.6	990.2	Net ROE (%)	(1.8)	(27.3)	(3.7)	67.6	50.9
Accounts payable	(28.3)	(30.1)	(3.5)	(43.7)	(71.7)	EBIT ROCE (%)	(2.8)	(23.8)	(2.9)	53.3	43.3
Other payable	-	-	-	-	-	Dividend payout (%)	-	-	-	-	-
Tax payable	(0.0)	(0.2)	(0.0)	(0.0)	(0.0)	Effective tax rate (%)	-	(0.8)	-	-	-
Due to related co.s	(0.2)	-	-	-	-	Net interest coverage (x)	2.8	29.6	72.7	na	na
ST debts	(4.3)	(3.5)	-	-	-	A/R turnover (days)	130.2	131.9	79.4	15.8	23.5
Other current liab.	-	-	-	-	-	A/P turnover (days)	286.5	304.7	175.1	19.7	29.4
LT debts	-	-	(83.2)	(70.0)	(70.0)	Stock turnover (days)	144.0	146.1	43.2	18.1	22.8
Other LT liabilities	-	-	-	-	-						
Total liabilities	(32.9)	(33.8)	(86.7)	(113.7)	(141.8)						
Share capital	8.4	8.4	16.4	17.1	17.1						
Reserves	112.1	86.1	221.6	483.4	825.0						
Shareholders' funds	120.5	94.4	237.9	500.5	842.1						
Minority interest	3.7	6.3	6.3	6.3	6.3						
Total	124.2	100.8	244.2	506.8	848.4						
Capital employed	128.5	104.2	327.4	576.8	918.4						
Net (debt)/cash	63.9	66.5	109.8	356.8	696.3						

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