China Medical Sector

Hong Kong/ China

Sector

China Pharmaceuticals
China Medical Devices
China Healthcare

Analysts

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The stars are aligned

The SFDA and NDRC's initiatives throughout 2005-2007 to restructure and clean up China's pharmaceutical industry have had the desired effect. Industry growth rates rebounded in 2007 to historical levels as the more stringent regulatory environment forced consolidation and weaker players out of the market. For 2007, pharmaceutical sales increased 24.9% YoY to RMB639.3b, driven by broad based growth across all sectors.

One of the reasons we are especially bullish on China's medical sector is that we see macro drivers within each segment of the vertical supply chain. These sectors include APIs, finished drugs, medical devices and healthcare.

Medical companies are invariably more difficult to appreciate for most investors as each pharmaceutical company is largely unique, with slightly different business models. To this end, we have provided a profile of 17 major pharmaceutical, medical devices and healthcare companies, complete with operation updates, investment themes and our views. The medical companies profiled are listed in Hong Kong, Singapore and the US.

Our top medical picks are **China Renji (648 HK, HK$0.067, BUY)** and **Sino-Biopharma (1177 HK, HK$1.44, BUY)**. We also have a conviction buy call on underappreciated **United Laboratories (3933 HK, HK$3.72, NR)**.

On a sector basis, we like the medical devices sector. **Shandong Weigao (8199 HK, HK$11.40, NR)**, **Mingyuan (233 HK, HK$0.98, NR)** are our favourites here. **Mindray (MR US, US$44.04, NR)** is also a key beneficiary.

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The stars are aligned

High industry growth rate restored

The SFDA and NDRC's initiatives throughout 2005-2007 to restructure and clean up China's pharmaceutical industry have had the desired effect. After a correction year in 2006, the industry growth rates rebounded in 2007 to historical levels as the more stringent regulatory environment forced consolidation and weaker players out of the market. For 2007, pharmaceutical sales increased 24.9% YoY to RMB639.3b. The growth has been broad based with chemical medicines, chemical raw materials and Chinese medicines growing at 23.6%, 25.1% and 24.1% YoY respectively. Sales of medical equipment and healthcare material continued its robust growth, surging 22.2% and 31.4% YoY respectively.

Table 1: Pharmaceutical product revenues

	2007 Revenue (RMBb)	YoY Chg (%)	1-2M 2008 Revenue (RMBb)	YoY Chg (%)
Chemical raw materials	149.7	25.1	25.6	30.0
Chemical medicines	168.5	23.6	30.4	21.9
Bio-chemical medicines	49.5	21.6	9.2	28.6
Chinese medicines	158.5	24.1	27.2	20.2
Medical equipment	59.3	22.2	10.0	29.1
Healthcare material	29.9	31.4	4.3	31.5
Others	23.9	-	3.9	35.3
Total	**639.3**	**24.9**	**110.6**	**25.3**

Source: PICO

Government policies continue to promote industry growth

Meanwhile, Chinese government policies continue to promote and underpin growth of the industry. This is especially the case in rural areas. According to Ministry of Finance of PRC (MoF), central government invested RMB66.4b in healthcare industry in 2007 and it plans to further invest RMB83.1b in 2008, a 25.2% YoY growth.

Much of this funding is aimed at improving medical coverage in rural areas. The results are starting to show. According to the data from Chinese medicine commerce committee, the medical sales in rural area grew at a CAGR of 34.4% from RMB17.8b in 2003 to RMB58.0b in 2007. Furthermore, Chen Zhu, the head of Ministry of Health of PRC (MoH), has indicated that central government subsidies to each person would be doubled from RMB40.0/year to RMB80.0/year.

Drivers abundant, located throughout the supply chain

One of the reasons we are especially bullish on China's medical sector is that we see macro drivers within each segment of the vertical supply chain (APIs, finished drugs, medical devices and healthcare). These include:

<u>Active pharmaceutical ingredients (APIs)</u>

- The lowering of wastewater discharge standard from 300 COD to 120 COD weeding out smaller, non-compliant manufacturers and raising entry barriers.
- China is the largest API producing country in the world, accounting for about 80% of global production.

<u>Finished drugs</u>

- Chinese government's 11th Five Year Plan targets to have 100% medical coverage in rural areas as well as other initiatives to improve urban medical coverage. This is driving spending and demand for finished drugs.
- Central government's investment budget of RMB83.1b for healthcare industry in 2008 is up 25.2% YoY.

<u>Medical devices</u>

- Consolidation in this sub-sector beginning to centralize products and distribution power within the leaders.

- Export opportunities to overseas countries emerging, supported by the fact it is arguably easier for medical device companies to obtain regulatory approval (relative to finished drugs manufacturers).

Healthcare

- Government is gradually opening up China's healthcare sector to foreign investment to speed up the development and improve the efficiency of the system. This offers opportunities for first movers with unique business models and resources to capitalise and become a leader.

17 medical companies profiled

Medical companies are invariably more difficult to appreciate for most investors as each pharmaceutical company is largely unique, with slightly different business models. For example, Shineway and Sino-Biopharma both have a strong presence in rural areas, but the former sells western Chinese medicine drugs while the latter sells biopharmaceutical drugs company with a focus on cardiovascular and hepatitis diseases. Meanwhile, C&O pharmaceuticals and United Laboratories sell competing antibiotics, but C&O has its own last mile distribution to hospitals, while United Laboratories uses third party distributors, and instead, utilizes its 2,000+ strong sales and marketing force to drive revenues.

To this end, we have provided a profile of 17 major pharmaceutical, medical devices and healthcare companies, complete with operation updates, investment themes and our views. The medical companies profiled are listed in Hong Kong, Singapore and the US.

Reiterating our investment thesis

Our investment thesis hasn't change. In fact, it is arguably more compelling in light of the current volatile market conditions of the market. We suggest investors look for medical companies with one or more of the following attributes:

- Strong cash generators with solid balance sheets, and low risk-to-reward valuation profiles;
- Broad product profile, combining strong cash generating drugs as well as emerging drugs that will become the next growth drivers;
- Execution ability to expedite SFDA regulatory approvals or companies with new drugs already launched or with product permits already obtained, ready to be launched onto the market;
- solid brand name or product awareness;
- strong and scalable operating networks of healthcare services;
- niche focus - provision of healthcare services directly or indirectly benefiting from growing demand for health check and healthcare insurances; and
- industry leading distribution networks.

Our picks and favourites

Our top medical picks are **China Renji (648 HK, HK$0.067, BUY)**, a specialist service provider with a focus on diagnosis and treatment of cancer and **Sino-Biopharma (1177 HK, HK$1.44, BUY)**, with its strong product awareness and emerging blockbuster drugs. We also have a conviction buy call on **United Laboratories (3933 HK, HK$3.72, NR)**, a vertically integrated drugs manufacturer with pricing power, in which we believe is underappreciated by the market by seeing it as a API manufacturer.

On a sector basis, we like the medical devices sector. This sector is subject to several drivers in our view, including: 1) government spending to improve medical infrastructure in rural and urban areas driving demand for consumable and non-consumable medical devices and 2) export opportunities to overseas markets. **Shandong Weigao (8199 HK, HK$11.40, NR)**, **Mingyuan (233 HK, HK$0.98, NR)** are our favourites here. **Mindray (MR US, US$44.04, NR)** is also a key beneficiary.

Company Profiles

China Pharmaceuticals

Guangzhou Pharm

Margin pressure

BUY (unchanged)

China Pharmaceuticals

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Our View

- The cold weather spell in 1Q and weaker than expected sales have led to the build up of inventory. Together with rising raw material costs, margins are likely to be under pressure.
- Though the new distribution JV with Alliance Boots holds significant long term prospects, we are not expecting much in the short-term. The new JV will require time to integrate new management, culture and operational practices before moving forward. We are expecting top line growth rate of 20.0% in FY12/08F, largely similar to FY12/07A.
- Despite facing near term headwinds, GP possesses valuable assets such as renowned TCM brands, manufacturing patents (消可丸), and China's second largest pharmaceutical distributor.
- The margin rebound we had previously expected in 2Q is unlikely to materialise. Therefore, we have revised down our net profit estimate for FY12/08F to RMB319.0m (previously RMB348.9m) and FY12/09F to RMB379.7m (previously RMB386.2m).
- The stock price has retreated from a high of around HK$7.15 in May to below HK$5.00. We believe that current levels undervalue the company. However near term, the counter appears to lack driving catalysts, while downside risks to our estimates remain. We maintain the BUY call and revise our sum-of-the-parts target price to HK$5.60, representing 16.4x FY12/08F P/E (excluding one-off items).

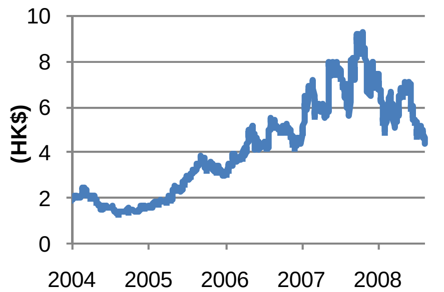
Stock data

Price	**HK$4.79**
Target price	HK$5.60 (+16.9%)
12 mth range	HK$4.60-9.55
Market cap.	US$989.1m
Daily t/o, 3 mth	US$0.5m
Free float %	27.1%
Ticker	0874.HK/874 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (RMBm)	10,241.0	12,260.7	9,543.7	11,404.9	13,199.8
NP (RMBm)	218.1	320.3	319.0	379.7	490.9
EPS(RMB)	0.269	0.395	0.393	0.468	0.605
EPS Δ %	10.2	46.9	(0.4)	19.0	29.3
P/E (x)	16.1	10.9	11.0	9.2	7.1
P/B (x)	1.21	1.11	0.99	0.92	0.80
EV/EBITDA (x)	13.8	11.7	13.4	9.2	7.1
Yield (%)	1.9	2.9	2.7	3.3	4.2
ROE (%)	7.8	10.6	9.5	10.4	12.0
ROCE (%)	10.1	11.5	8.0	11.5	13.3
N. Gear. (%)	13.3	6.3	Cash	Cash	Cash

Price Chart



Company background. Guangzhou Pharmaceuticals (GP) is engaged in pharmaceutical manufacturing, distribution and retail business in China. It has a portfolio of more than 450 western medicines, traditional Chinese medicines (TCM) and healthcare products. It is the exclusive manufacturer and distributor of around 20 TCMs, including some time-honoured brands such as Pan Gao Shou (潘高寿), Jing Xiu Tang (敬修堂), Chen Li Ji (陈李济) and Wang Lao Ji (王老吉).

What's new

- Several of GP's subsidiaries, including Xing Qun, Qi Xing, Zhong Yi, Jing Xiu Tang, has seen inventory build up in its manufacturing supply chain. The respective entities are presently clearing out this inventory.
- Management indicated that Wang Lao Ji herb tea continues to see strong demand. Our channel checks suggests that the "red can" label has spent substantial amounts on advertising and brand building during the Olympic year. This gives us confidence that Wang Lao Ji JV (which manufactures the "green label" products) can maintain strong growth momentum. The JV grew 44.0% YoY in 1Q FY12/08A and we estimate it to grow 45.0% for the full year.
- GP has received SFDA product approval and GMP certificates for its Rabies vaccine. Management expects to commence production in Oct 2008.

Investment theme

- GP has a solid foundation with reputable assets. It makes more than 400 types of western and traditional Chinese (TCM) and has a distribution portfolio of over 4,000 medicine and healthcare products.
- GP's distribution subsidiary was China second largest distributor with a network covering 2,000 hospitals, 5,000 distributors and 1,000 retailers. Its JV with Alliance Boots will benefit the long term development of the company including: 1) distribution of Alliance Boots' pharmaceutical and beauty related healthcare product in China; 2) M&A expertise from Alliance BMP-help with the expansion of the distribution net work in China; 3) best practice and management know-how; and 4) OEM opportunities.
- Xiaokewan (消可丸) is China's second most popular oral drug to treat Type II diabetes, with unique positioning as a Western Chinese medicine. Type II diabetes is an emerging health problem in China. It is estimated that there are around 40m patients and growing at a rate of around 20.0% annually. However, only around 25% of Type II diabetes suffers currently takes medication to treat the disease. Sales of the patented drug rose 18.7% YoY to RMB527.0m in FY12/07A.
- GP is a quasi domestic consumption play as its Wang Lao Ji herbal tea is one of China's most popular beverage drinks.

Risks

- Slow down in consumer spending.
- Company could not effectively control the cost and expenditure of its many subsidiaries.
- Company failed to corporate well with Alliance BMP.

Table 1: P&L

Year to Dec (RMBm)	06A	07A	08F	09F	10F
Turnover	**10,241.0**	**12,260.7**	**9,543.7**	**11,404.9**	**13,199.8**
Cost of sales	(8,472.2)	(10,245.3)	(7.917.8)	(9,427.9)	(10.843.6)
Gross profit	**1,768.8**	**2,015.5**	**1,625.9**	**1,977.0**	**2,356.2**
Other income and gains	75.2	80.2	62.3	68.4	79.2
Selling and distribution costs	(778.2)	(1,057.3)	(856.8)	(969.6)	(1,168.2)
Administrative expenses	(656.5)	(554.2)	(477.2)	(522.6)	(607.2)
Other operating expenses	(14.5)	(4.5)	(4.2)	(8.8)	(6.6)
Operating profit	**394.8**	**479.8**	**350.0**	**514.4**	**653.4**
Finance costs, net	(45.4)	(59.7)	(30.1)	(30.1)	(30.1)
Share of profits of an associate	(0.3)	7.9	-	-	-
Exceptionals	-	28.8	56.0	-	-
Profit before taxation	**349.2**	**456.8**	**375.9**	**484.3**	**623.3**
Taxation	(118.6)	(127.0)	(51.5)	(96.9)	(124.7)
Profit after tax	**230.6**	**329.9**	**324.3**	**387.4**	**498.6**
Minority interests	(12.5)	(9.5)	(5.4)	(7.7)	(7.7)
Profit attributable to shareholders	**218.1**	**320.3**	**319.0**	**379.7**	**490.9**

Source: Company data, SBI E2-Capital

China Pharmaceutical

Consolidated Vitamin C leader

Not Rated

Our View

- With API prices for amoxicillin and penicillin at healthy levels, and Vitamin C at record prices, CP recorded strong 1Q FY12/08A growth (net profit up 640.3%). We expect this to underpin the company's growth in FY12/08F.
- Our channel checks suggest that all key Vitamin C raw material manufacturers appear to be competing rationally. With current average prices at around US$10.00/kg for CP, we estimate that the CP can maintain gross margins of around 50.0%.
- Vitamin C is a key driver for the company, both in its API segment and in its finished drugs segment (OTC Vitamin C supplement).
- We expect that improving performance in its finished drugs segment to markedly improve the profitability of CP. Revenue grew 37.2% YoY to HK$454.2m in 1Q FY12/08A. The segment recorded a profit of HK$33.6m, reversing a loss of HK$11.5m a year ago.
- With production scale operating in a rational competition environment, CP is a key beneficiary of rising raw material prices. The counter is currently trading at 8.2x FY12/08F P/E, 7.9x FY12/09F P/E based on market consensus.

China Pharmaceuticals

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Stock data

Price	**HK$2.78**
Target price	N/A
12 mth range	HK$1.8-4.95
Market cap.	US$533.7m
Daily t/o, 3 mth	US$3.6m
Free float %	49.1%
Ticker	1093.HK/1093 HK

Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (HK$m)	3,192.1	3,538.8	4,986.1	5,300.8	5,815.5
NP (HK$m)	156.5	15.7	477.4	1,118.0	1,147.7
EPS (HK$)	0.102	0.010	0.310	0.340	0.354
EPS Δ %	(36.1)	(90.2)	300.0	9.7	4.1
P/E (x)	27.3	278.0	9.0	8.2	7.9
P/B (x)	1.7	1.6	1.5	1.1	1.0
EV/EBITDA (x)	6.5	7.1	5.3	5.2	5.3
Yield (%)	N/A	N/A	1.7	2.4	1.6
ROE (%)	6.6	0.61	15.9	14.5	13.3
ROCE (%)	N/A	N/A	11.8	-	-
N. Gear. (%)	42.0	54.8	51.5	23.6	7.9

Price Chart

Company background. China Pharmaceutical (CP) is one of the world's largest active pharmaceutical ingredients (API) producers. The company has a broad portfolio of products including penicillin (penicillin salt, amoxicillin and 6-APA), cephalosporin (7-ACA), Vitamin C, as well as finished drugs. Typically, its customers are bulk drugs manufacturers which purchases CP's products for manufacturing of subsequent finished drugs. The company was listed on the HKEx main board in 1994.

What's new

- CP announced 1QFY12/08A results recently. Revenue increased 51.0% YoY to HK$1,553.5m, while net profit jumped 640.3% YoY to HK$151.9m. The growth was mainly driven by surging prices of vitamin C, amoxicillin and 7-ACA.
- For1Q, vitamin C price was US$6.77/kg (up 124.2% YoY), while amoxicillin price US$30.90 (up 12.0% YoY) and 7-ACA price US$90.61/kg (up 9.4% YoY). For other products, penicillin salt was US$11.59/kg (down 10.6% YoY), 6-APA was US$26.88/kg (down 3.5% YoY).
- Management indicated that average Vitamin C prices have further risen to around US$8.0/kg, though they expect it to moderate from current high levels going forward.
- Key growth driver in the finished drugs segment is the OTC vitamin C supplement. It recorded revenues of around RMB70.0m in FY12/07A and management is targeting RMB100.0m in FY12/08F, up around 40.0% YoY. Gross margins for this product is around 70%, significantly higher than the average segment gross margin of 25.0% for finished drugs.
- Capex plan of about RMB400.0m for FY12/08F. RMB70.0-80.0m for upgrading water treatment facilities, RMB100.0m for developing new business and the remaining capex for business maintenance.

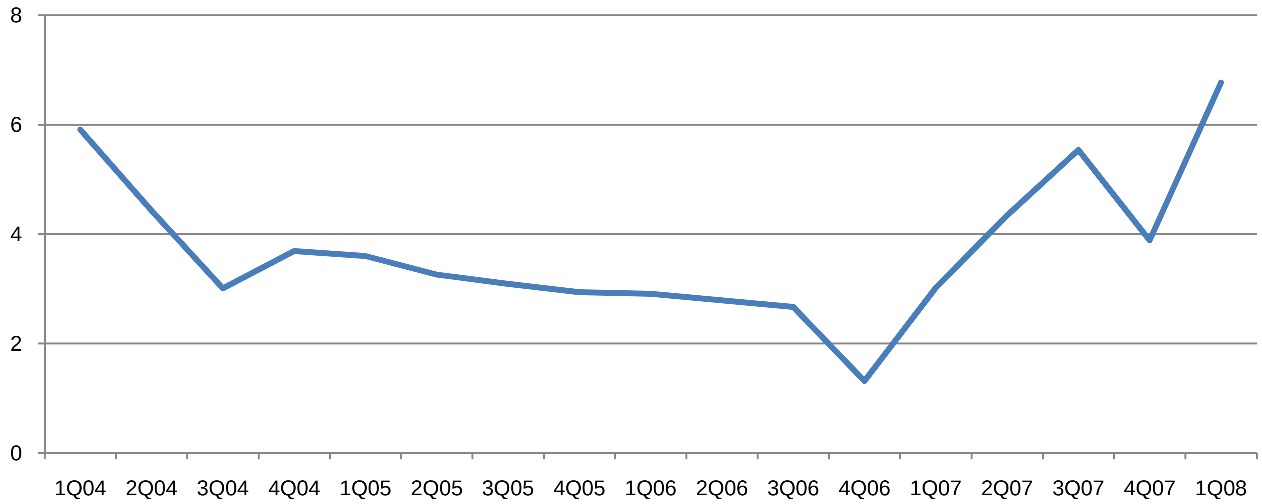
Investment theme

- With manufacturing factories in Shijiazhuan City, Henan Province and in Inner Mogolia, CP's API capacity include 30,000 tonnes of Vitamin C, 8,500 tonnes of penicillin salt, 4,000 tonnes of 6 APA (2,500 tonnes of them was made from corn starch directly, 1,500 tonnes of them was made from penicillin salt), 4,500 tonnes of amoxicillin bulk medicine, and 1,200 tonnes of 7-ACA.
- CP is the largest Vitamin C raw material supplier in the world, accounting for about 30% of the world production in 2007. China accounts for around 80% of global supply for Vitamin C raw material. Industry has consolidated to mainly 5 players, all of which are located in China. With no irrational capacity increases and/or pricing amongst the leaders. Vitamin C prices should be sustained at a healthy level going forward.
- The government's new standard for polluted water treatment has raised barriers for new entrants while driving out smaller players. This has driven up the API price, in particularly the price of vitamin C has reached historical high and the price penicillin salt series raw material has recovered to a high level as well. 6-APA prices reached around US$48.9/kg in Jun 2008.

Risks

- Competition in OTC vitamin C supplements.
- Irrational capacity expansion by industry competitors driving down vitamin C prices.
- New large Vitamin C producer entering into the market.
- Significant price declines in other APIs.

Chart 1: 2004-2008 CP's Vitamin C Price Trend (US$/kg)



Source: company data & SBI E2-Capital

Table 1: P&L

Year to Dec (HK$m)	05A	06A	07A	08F	09F
Turnover					
Penicillin series	525.1	1,016.2	1,617.0	-	-
Cephalosporin series	855.1	672.0	767.7	-	-
Vitamin C	692.5	575.3	1,102.1	-	-
Finished Drugs	1,110.0	1,255.5	1,464.0	-	-
Others	9.4	19.8	35.2	-	-
	3,192.1	**3,538.8**	**4,986.1**	**5300.8**	**5815.5**
Cost of sales	(2,498.5)	(2,925.4)	(3,449.6)	-	-
Gross profit	**693.6**	**613.3**	**1,536.4**	**-**	**-**
Other income	21.2	34.8	27.3	-	-
Selling and distribution costs	(182.7)	(232.5)	(379.2)	-	-
Administrative expenses	(293.2)	(308.1)	(471.3)	-	-
Other expenses	(20.5)	(6.8)	(74.8)	-	-
Operating profit	**218.4**	**100.8**	**638.4**	**-**	**-**
Share of loss of a JCE	(1.1)	(3.4)	(2.7)	-	-
Chg in FV of derivative instrument	-	-	(0.6)	-	-
Financial costs	(68.1)	(95.8)	(112.8)	-	-
Pre-tax profit	**149.0**	**1.6**	**522.3**	**-**	**-**
Tax	7.3	13.8	(45.6)	-	-
Minority interests	0.2	0.3	0.6	-	-
Net profit	**156.5**	**15.7**	**477.4**	**1,118.0**	**1,147.7**

Source: Company data & Bloomberg Estimates

Sino-Biopharma

Little known gem

BUY (unchanged)

Our View

- We like SB for its drug portfolio mix. Incumbent blockbuster drugs such as Kaishi injection are strong cash cows while still delivering respectable growth. Meanwhile, new emerging drugs such as Mingzheng capsules are ramping up fast to become the next blockbuster drug amongst its portfolio.
- We believe the re-acceleration of growth in its Kaishi injection drug is evidence that the more stringent regulatory environment is lengthening the product life cycles of SB's drugs.
- With new drugs either recently launched or already in the ramp up phase, the company is buffered against the more stringent product approval process introduced by the SFDA.
- Its strong gross margins (82.3% in FY12/07A) give it ample room to absorb raw material price increases.
- We see SB as a high organic growth play, rather than M&A play (despite its sizeable HK$1,913.6m cash hoard) as the company has historically taken a conservative approach towards M&As.
- One negative aspect of SB is its difficulty in getting access to management.
- We maintain our BUY call on the counter, target price HK$2.27 representing 14.0x FY12/09F ex-cash P/E, 57.6% upside.

China Pharmaceuticals

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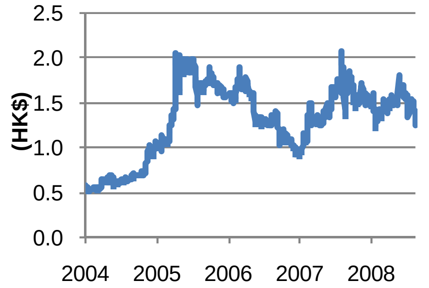
Stock data

Price	**HK$1.44**
Target price	HK$2.27 (+58%)
12 mth range	HK$1.210-1.890
Market cap.	US$405.7m
Daily t/o, 3 mth	US$0.5m
Free float %	44.7%
Ticker	1177.HK/1177 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (HK$m)	734.7	1,164.3	1,711.2	1,972.5	2,327.6
NP (HK$m)	141.2	224.4	302.8	339.9	405.4
EPS (HK$)	0.062	0.099	0.134	0.150	0.179
EPS △%	(91.3)	58.9	35.0	12.2	19.3
P/E (x)	20.8	13.1	9.7	8.6	7.2
P/B (x)	1.54	1.45	1.21	1.11	1.01
EV/EBITDA (x)	14.0	5.9	3.3	2.7	1.8
Yield (%)	3.9	4.6	6.2	7.0	8.3
ROE (%)	7.5	11.4	13.7	13.4	14.6
ROCE (%)	6.3	12.3	17.4	17.6	19.8
N. Gear. (%)	84.1	83.5	80.3	76.7	76.9

Price Chart



Company background. Sino-Biopharmaceutical (SB) is principally engaged in the development, manufacture and sale of different types of health enhancing biopharmaceuticals, modernized Chinese medicines and chemical medicines in 3 major categories: 1) cardio-cerebral medicines; 2) hepatitis medicines; 3) oncology medicines. Through its various subsidiaries, SB develops and sells "blockbuster" drugs, that is, proprietary drugs that can deliver revenues in excess of HK$100m annually. The company's flagship product is Kaishi, a targeted and sustained release injection for treating cardio-cerebral diseases with revenues of HK$443.2m in FY12/07A. In the hepatitis segment, Ganlixin injections and capsules generated HK$268.7m in FY12/07A.

What's new

- 1Q FY12/08A results exceeded our expectations. Revenue rose 123.9% YoY and 56.3% QoQ to HK$507.9m driven by old and new blockbuster drugs. Net profit increased 139.2% YoY and 1.3% QoQ to HK$76.9m. The gross margin narrowed 2.6 pcp YoY and 8.5 pcp QoQ while the net margin widened 1.0 pcp YoY and narrowed 8.3 pcp QoQ, due to growing raw material costs and high other expenses, which grew 140.3% YoY and 462.3% QoQ.
- Both incumbent and new drugs are performing for the company. Sales of Kaishi injection, an old cardio-cerebral medicine, increased 39.1% YoY and 7.6% QoQ to HK$132.9m and of Mingzheng capsules, a hepatitis medicine launched in 2006, 227.0% YoY and 53.0% QoQ to HK$112.9m.

- At the end of 1Q FY12/08A, SB had RMB1,913.6m in cash at hand (HK$0.845/share), or 58.7% of its share price.
- Company announced that it has dropped plans to spin-off JCTT for listing on the Shenzhen Stock Exchange. JCTT is SBs' key subsidiary for manufacturing hepatitis drugs.
- SB announced that it will acquire 51.0% of Qingdao Haier Pharmaceutical (QH) on July 2008 at a consideration of RMB38.25m, representing 28.0x FY12/07A P/E. QH is focus on manufacturing, sale of pharmaceutical products and health food.

Investment theme

- The reformed pharmaceutical industry, with a more regulated operating environment and more stringent new product approval procedures, favours companies with an incumbent strong portfolio of drugs with good brand awareness. This is because product life cycles of incumbent drugs will be lengthened as less new substitute and competing drugs are launched onto the market.
- Many of SB's potential blockbuster drugs have already obtained SFDA approvals and are already on the market, which sidesteps the new, more stringent drug registration procedures. Company now focused on driving their sales through marketing efforts to turn the pipeline into sustainable revenue growth.
- SB's drugs are commonly used and will benefit from Chinese government's medical system reforms, which includes 100.0% medical insurance coverage available to all residents by 2010. Central government's plan to invest RMB83.1b into the healthcare industry in 2008 is up 25.2% YoY.
- SB's scale and focus on blockbuster drugs allows it to generate high margins. In FY12/07A, gross margin was 82.3% (FY12/06A: 81.1%) and net margin was 19.3% (FY12/06A 19.2%). Company maintains a payout ratio of 60.0% and is the only pharmaceutical company to distribute dividends every quarter.

Risks

- Failure of new drugs to ramp up to become blockbuster drugs.
- Faster than expected sales decline in existing blockbuster drugs.
- Further restructuring/tightening regulations from government negatively affecting the pharmaceutical industry.

Table 1: P&L

Year to Dec (HK$m)	06A	07A	08F	09F	10F
Turnover	**734.7**	**1,164.3**	**1,711.2**	**1,972.5**	**2,327.6**
Cost of sales	(138.8)	(205.8)	(344.4)	(374.8)	(442.3)
Gross profit	**595.9**	**958.5**	**1,366.7**	**1,597.7**	**1,885.4**
Other income and gains	91.5	98.4	107.7	96.6	101.2
Selling and distribution costs	(327.7)	(503.8)	(713.6)	(828.5)	(977.6)
Administrative expenses	(121.8)	(154.7)	(194.6)	(236.7)	(256.0)
Other operating expenses	(31.3)	(53.7)	(62.4)	(71.9)	(84.8)
Operating profit	**206.6**	**344.7**	**-**	**-**	**-**
Finance costs, net	(2.2)	(2.6)	(5.1)	(3.9)	(4.7)
Share of profits of an associated	0.7	0.2	0.2	0.4	0.5
Exceptionals	-	-	-	-	-
Profit before taxation	**205.1**	**342.3**	**499.0**	**553.7**	**663.9**
Taxation	(22.1)	(34.0)	(77.0)	(83.1)	(99.6)
Profit after tax	**183.0**	**308.3**	**422.0**	**470.7**	**564.3**
Minority interests	(41.8)	(84.0)	(119.1)	(130.8)	(158.9)
Profit attributable to shareholders	**141.2**	**224.4**	**302.8**	**339.9**	**405.4**

Source: Company data, SBI E2-Capital

Shineway

Riding the rural wave

Not Rated

China Pharmaceuticals

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Our View

- Shineway is a beneficiary of the government's aggressive reforms and improving coverage of medical coverage in rural areas. Its products are mainly sold in 2nd and 3rd tier cities.
- With higher medical subsidies for the rural population, demand for its modern Chinese medicines is set to increase. Our back-of-pad estimate suggests that 1H FY12/08F revenues should increase at close to 25.0-30.0% YoY.
- Company appears to be conservative, with only incremental product launches and capacity expansion over the past few years. In fact, it had a supply constraint in FY12/07A when it needed to divert manufacturing capacity away from its Shen Mai injection in order to meet demand for Shu Xue Ning injection. Hence, the rebounding growth in Shen Mai in 1Q FY12/08A.
- Despite the anticipated strong growth in 1H FY12/08F, the company appears to lack a clear competitive advantage. It typically grows at close to industry growth rates. In FY12/07A, its 47.3% YoY net profit increase was boosted by RMB166.7m gains in trading investments. Excluding one-off items, net profit only grew 14.4% YoY.
- Valuation appears to be attractive, trading at a forward FY12/08F ex-cash P/E of 6.3x on consensus.

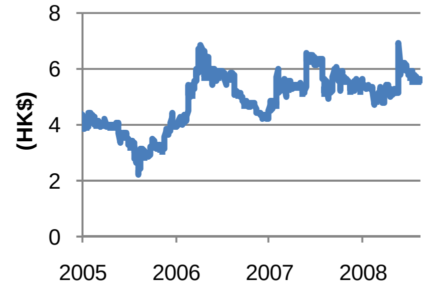
Stock data

Price	**HK$5.60**
Target price	N/A
12 mth range	HK$4.41-7.3
Market cap.	US$591.7m
Daily t/o, 3 mth	US$0.1m
Free float %	28.9%
Ticker	2877.HK/2877 HK

Financial summary

Year to Dec	05A	06A	07A	08F	09F
Turnover (RMBm)	831.4	841.5	1,012.9	1,267.1	1,561.6
Net profit (RMBm)	331.5	333.0	490.6	531.7	650.3
EPS (RMB)	0.400	0.400	0.590	0.559	0.669
EPS Δ %	(4.7)	0.0	47.5	(5.3)	19.7
P/E (x)	14.0	14.0	9.5	10.0	8.4
P/B (x)	2.8	2.6	2.2	1.8	1.6
EV/EBITDA (x)	6.2	6.3	6.3	4.5	3.7
Yield (%)	4.9	4.4	4.2	5.4	6.5
ROE (%)	19.4	17.3	22.2	20.3	21.7
ROCE (%)	22.6	20.4	26.5	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. Shineway is the largest Chinese medicine injection and soft capsule manufacturer in China by sales volume and production capacity. Focusing on 2nd and 3rd tier cities, the company owns around 180 formulae. Its portfolio mainly consists 11 products treating cardiovascular and anti-viral diseases. It comprises 3 core products (>RMB150.0m) and 8 emerging products (>RMB10.0m).

What's new

- Shineway's core products showed strong growth in 1Q FY12/08A. Shen Mai injection grew 18.6% YoY, Qing Kai Ling injection grew 29.2% YoY and Wufu Xin Nao Qing Soft Capsule grew 17.0% YoY. These growth rates compare to 4.1%, 19.8% and 5.4% respectively for the whole of FY12/07A.
- The company's four emerging products, namely: 1) Shu Xue Ning injection; 2) Huo Xiang Zheng Qi soft capsule; 3) Huang Qi injection and 4) Qing Kai Long soft capsule also sustained strong growth momentum, growing 27.7%, 27.0%, 37.6% and 51.5% respectively.
- The company expects its 3 emerging OTC products to be main driving force for FY12/08F. Huo Xian Zheng Qi soft capsule, Qing Kai Ling soft capsule and its capsule to treat child ailments recorded revenues of RMB50.5m, RMB24.0m and RM50.0m in FY12/07A. The company will increase its advertising spend for these 3 products to RMB100m (FY12/07A: RMB50m) to drive sales, with an aim to record revenues in the region of RMB80.0-100.0m for each these products in FY12/08F.

Investment theme

- In the 11th Five-Year Plan, the government aims to improve medical coverage in the rural areas to 100% by 2010. In 2007, the local government and central government together improved its contribution to each person in rural areas from RMB40/year to RMB80/year, further driving demand for pharmaceutical products.
- According to the Chinese Medicine Commerce Committee, medical sales in rural areas grew at a CAGR of 34.4% from RMB17.8b in 2003 to RMB58.0b in 2007. The rural cooperative medical scheme will cover all rural area by the end of 2008.
- Company has a strong cash hoard of HK$1,678.4m at the end of FY12/07A, equivalent to HK$2.03 cash per share. This puts the company in a strong position to benefit within a consolidating sector, as it undertakes M&A activities.

Risks

- Changes to government policies relating to the rural medical system coverage.
- Significant rise in raw material prices.
- Adverse inclement weather events affecting the supply of herbal raw materials.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	**831.4**	**841.5**	**1,012.9**	**1,267.1**	**1,561.6**
Cost of sales	(274.8)	(249.2)	(247.8)	-	-
Gross profit	**556.6**	**592.3**	**738.0**	**-**	**-**
Investment income	18.2	44.8	207.2	-	-
Other income	-	1.5	26.6	-	-
Selling and distribution costs	(160.9)	(183.8)	(258.1)	-	-
Net exchange loss	-	-	(57.0)	-	-
Administrative expenses	(71.5)	(67.7)	(80.9)	-	-
Operating profit	**342.5**	**387.0**	**575.9**	-	-
Finance costs	-	-	-	-	-
Profit before tax	**342.5**	**387.0**	**575.9**	-	-
Tax	(5.4)	(54.0)	(85.3)	-	-
Profit after tax	**337.0**	**333.0**	**490.6**	-	-
Minority interest	(5.5)	-	-	-	-
Net profit	**331.5**	**333.0**	**490.6**	**531.7**	**650.3**

Source: Company data, Bloomberg Estimates

United Laboratories

Value goes beyond 6-APA

Not Rated

China Pharmaceuticals

Fri, 15 Aug 2008

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Our View

- Investors should take a holistic view when looking at ULI. Value of the company goes beyond 6-APA. Finished products is a core part of its business model. For FY12/07A, finished products accounted for 37.3% of overall revenues, up 20.0% YoY. By comparison, external sales of intermediate products (incl. 6-APA) only accounted for 10.2% of revenues.
- Expansion of 6-APA capacity is aggressive, but we expect the company to be rational in production volumes, reacting to actual demand, rather than flood the market. In our view, adding the required 6-APA capacity for medium term now is a good strategy. They already have scale so adding capacity is relatively inexpensive (RMB1.0m/tonne). Having flexibility in production is an advantage as 6-APA faces more demand profiles (end user antibiotics, domestic and overseas demand for both 6-APA and derivative mid-stream products), when compared to downstream finished products line.
- ULI is a beneficiary of China's rural medical coverage reform and increasing medical subsidies in urban areas. Their expansion of finish products capacity reinforces this view. The larger downstream capacity will also aid in maintaining adequate utilisation of its 6-APA and amoxicillin bulk medicine lines. In FY12/07A, ULI only sold around 1/3 of its 6-APA production externally, consuming the remaining internally.
- The company has leveraged recent strong 6-APA prices to aggressively build out its sales force for finished products to 1,800 at the end of last year (FY12/06A: 800). Management wants to further expand this force to 2,400 by end of FY12/08.
- ULI has positioned its finished products line to takeover as the company's next growth driver when 6-APA prices eventually moderates. Its vertical integration and pricing power will allow it to better control costs. Based on our back-of-pad calculations, the counter is trading at an undemanding 5.6x FY12/09F P/E.

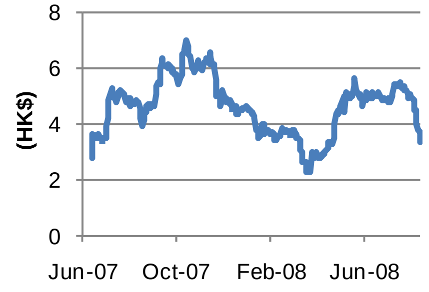
Stock data

Price	**HK$3.72**
Target price	N/A
12 mth range	HK$2.10-7.20
Market cap.	US$508.6m
Daily t/o, 3 mth	US$1.3m
Free float %	28.3%
Ticker	3933.HK/3933 HK

Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (HK$m)	1,720.4	2,080.5	2,594.9	3,791.3	4,053.6
NP (HK$m)	116.6	173.8	510.5	683.5	796.5
EPS (HK$)	0.097	0.145	0.425	0.570	0.664
EPS Δ %	-	49.5	193.1	33.9	16.5
P/E (x)	38.3	25.7	8.7	6.5	5.6
P/B (x)	4.4	3.4	1.8	1.6	1.3
EV/EBITDA (x)	72.1	48.1	10.9	9.2	7.5
Yield (%)	-	-	4.6	5.4	6.2
ROE (%)	11.5	15.0	27.1	25.7	25.1
ROCE (%)	N/A	N/A	117.3	74.4	60.1
N. Gear. (%)	89.2	98.5	51.8	49.0	28.0

Price Chart



Company background. United Laboratories International (ULI) is a vertically-integrated producer and distributor of intermediate antibiotics, bulk medicines and finished products. The company was listed on the main board of the HKEx on 15 Jun 2007, with an offer price of HK$2.75 per share. It is China's largest 6-APA producer with an estimated market share of around 35% in 2007 and one of the largest in the world.

What's new

- ULI current API production capacities are: 1) 8,467 tonnes of 6-APA; 2) 3,769 tonnes amoxicillin bulk medicine and 662 tonnes cephalosporin's bulk medicine.

- It plans to add 3,000 tonnes 6-APA in FY12/09, taking overall capacity to around 11,500 tonnes. We estimate that this would account for around 50% of China's total production capacity in 2009. The company will also add 3,000 tonnes to its amoxicillin bulk medicine capacity.
- ULI will increase its finished products capacity by around 30.0% in FY12/08 and a further 15.0%-50.0% in FY12/09. The increase in production of downstream products will absorb a portion of the newly added upstream capacities.
- 6-APA prices continue to be sustained at a relatively high level. Seasonally strong demand in 1Q 2008 and reduced production of China North Pharmaceutical (600812 CH) gradually pushed prices to RMB350/kg in May 2008, and current prices are around RMB290-300/kg. We expect 6-APA prices to trend down in 3Q on seasonally lower demand. Manufacturers typically carry out their maintenance works during this quarter.
- ULI is beginning to realise the benefits of a larger sales force and favourable government policies towards rural and urban medical coverage through increased demand for their finished products. We estimate that finish products revenues should grow at around 20.0-25.0% YoY in 1H FY12/08F.
- New drug approval continues to be difficult under the tighter regulatory environment. Management expects only to receive 2 SFDA product approvals this year, down from the previous estimate of 7. It is now expected that the product approvals for the remaining 5 products will be obtained in 2009.

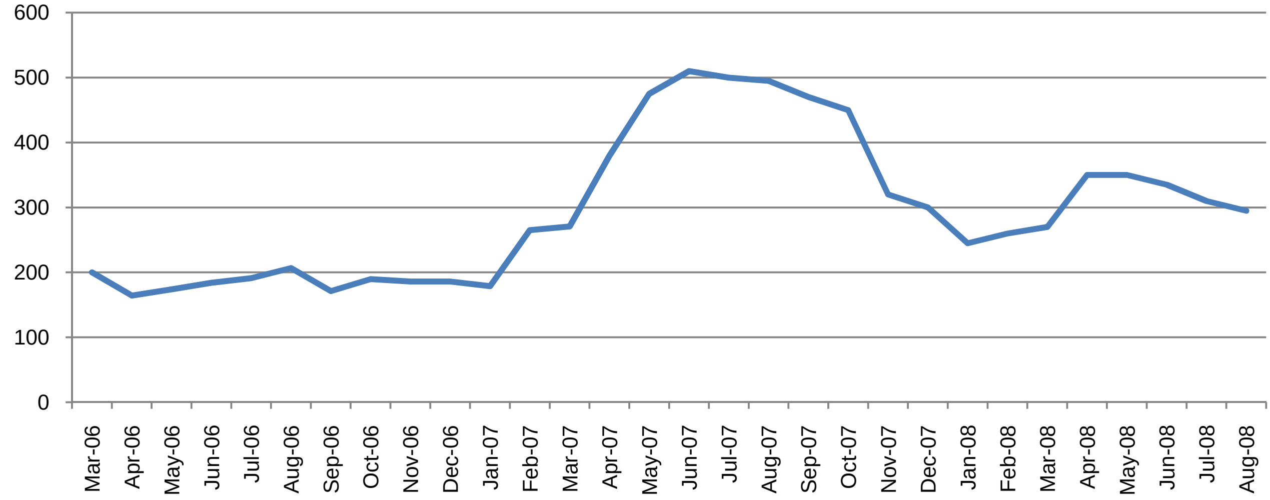
Investment theme

- ULI's vertically integrated model not only allows it to better control production costs, but builds into the business model a hedging mechanism that mitigates the adverse effects of fluctuating bulk medicine raw material prices.
- ULI has special concession from the SFDA to set prices above NDRC price caps for five of its finished antibiotics (Amoxicillin Capsules 250mg and 500mg, Ampicillin Capsules 250mg and 500mg and Amoxicillin Granules). Hence its operating margins of 24.3% (FY12/07A) for the finished products segment are comparatively higher than industry average of around 15.0%.
- China's government continues to reform its medical system under its 11th Five Year Plan, with an aim to have medical insurance coverage available to all residents by 2010. Central government's plan to invest RMB83.1b into healthcare industry in 2008 is up 25.2% YoY.
- Key beneficiary of: 1) rising raw material prices in China's pharmaceutical sector; 2) a tighter regulatory environment from government initiatives in 2006 and 2007 and 3) increased focus on product quality and reducing pollution. According to the 制药工业污染物排放标准 issued on 1 Aug 2008, new plants will need to achieve a wastewater discharge of 120 COD (chemical oxygen demand), while existing plants will have a two-year grace period to reduce its discharge standard from the current 300 COD to 120 COD by 2010. We expect the new stricter standards to force out smaller players and raise entry barriers.

Risks

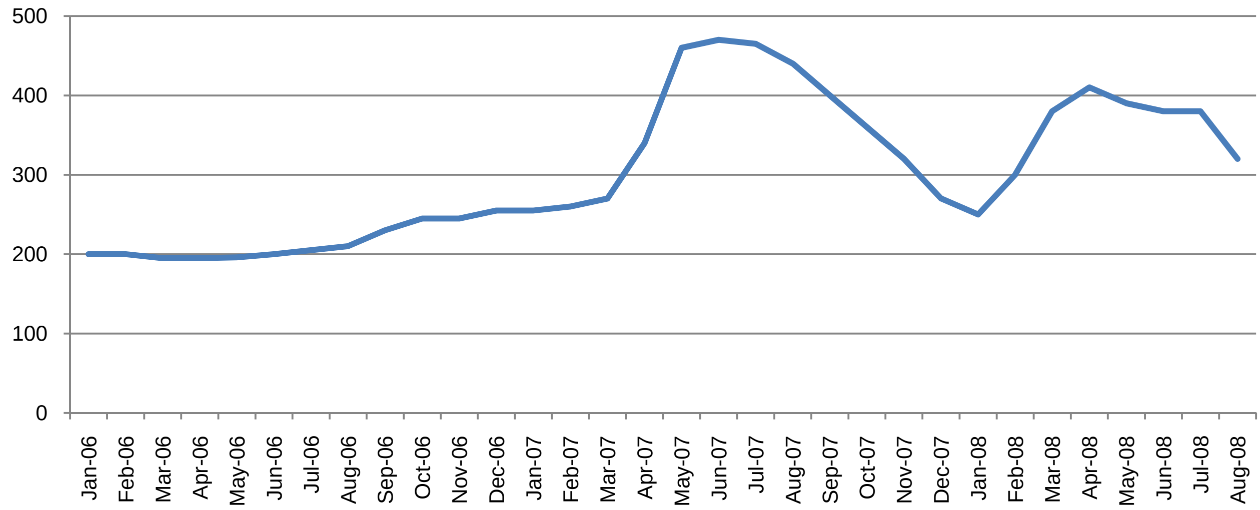
- Further government regulatory reforms in the pharmaceutical/healthcare market.
- Slow down in economy leading to lower consumption of pharmaceutical medicines.
- Irrational increase in API capacity by competitors substantially lowering sale prices.

Chart 1: 2006-2008 6-APA Price Trend (RMB/kg)



Source: www.healthoo.com &SBI E2-Capital

Chart 2: 2006-2008 Amoxicilin Bulk Medicine Price Trend (RMB/kg)



Source: www.healthoo.com &SBI E2-Capital

Table 1: P&L

Year to Dec (HK$m)	05A	06A	07A	08F	09F
Turnover	**1,720.4**	**2,080.5**	**2,594.9**	**3791.3**	**4,053.6**
Cost of sales	(1,120.7)	(1,344.2)	(1,389.2)	(2,346.9)	(2,413.0)
Gross profit	**599.8**	**736.3**	**1,205.8**	**1,444.5**	**1,640.6**
Other income and gains	12.9	9.9	25.8.	15.0	14.0
Selling and distribution costs	(261.2)	(284.1)	(381.5)	(423.5)	(481.9)
Administrative expenses	(104.9)	(123.0)	(173.3)	(181.5)	(206.5)
Other operating expenses	(15.4)	(37.8)	(38.4)	(10.0)	(10.0)
Operating profit	**231.1**	**301.3**	**638.3**	**844.4**	**956.3**
Finance costs, net	(47.4)	(85.5)	(80.0)	(97.4)	(85.8)
Share of results of an associate	(8.3)	(2.7)	-	-	-
Gain on disposal of an associate	-	8.6	-	-	-
Profit before taxation	**175.5**	**221.8**	**558.3**	**747.0**	**870.5**
Taxation	(42.5)	(47.9)	(47.9)	(63.5)	(74.0)
Profit after tax	**132.9**	**173.8**	**510.5**	**683.5**	**796.5**
Minority interests	(16.4)	-	-	-	-
Profit attributable to shareholders	**116.6**	**173.8**	**510.5**	**683.5**	**796.5**

Source: Company data, SBI E2-Capital

Shandong Luoxin

Sustaining high growth

Not Rated

Our View

- We like the Luoxin for its lean cost structure. Thus, the company experience significant operating leveraging as it is able to expand its top line. In 1H FY12/08A, gross margins improved 4.3 pcp YoY to 48.6%.
- In our view, Luoxin's key competitive advantage is its execution ability with respect to obtaining SFDA product approvals. The company was able record a strong 27.3% revenue growth in FY12/06A, despite the regulatory-led industry restructuring in due to aggressive new product launches. That year, the company received approvals for 40 drugs.
- We think that the Qilu acquisition is one of positioning. The newly acquired 20.0%-owned company is partially owned by Qilu Hospital (山东大学济鲁医院), one of the most renowned hospitals in Shandong Province. We expect that company may start distributing medicines to this hospital going forward. From our channel checks, we understand that Qilu Hospitals procures some RMB500-600m worth of drugs annually.
- With new drug launches and a gradual shift in clientele (from Grade 2 to Grade 3 hospitals), we think that Luoxin can continue to grow its top line. However, margin expansion going forward may moderate due to higher depreciation charges and increased competition for distribution to the larger hospitals.
- The counter is currently trading at 12.2x FY12/08F and 9.1x FY12/09F P/E.

China Pharmaceuticals

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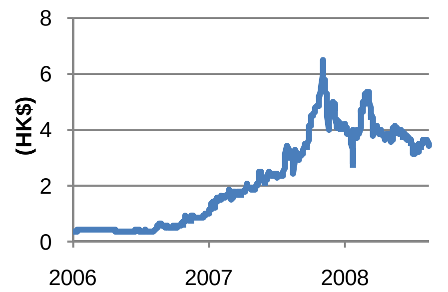
Stock data

Price	HK$3.54
Target price	N/A
12 mth range	HK$2.30-6.65
Market cap.	US$280.9m
Daily t/o, 3 mth	US$0.1m
Free float %	27.0%
Ticker	8058.HK/8058 HK

Financial summary

Year to Dec	05A	06A	07A	08F	09F
Turnover (RMBm)	249.7	317.9	509.1	743.0	1,023.0
Net profit (RMBm)	36.9	60.2	121.9	285.0	391.0
EPS (RMB)	0.079	0.099	0.200	0.290	0.390
EPS Δ %	29.6	25.3	102.2	45.0	34.5
P/E (x)	44.8	35.8	17.7	12.2	9.1
P/B (x)	13.1	10.1	6.7	2.7	2.1
EV/EBITDA (x)	2.7	5.7	12.3	6.7	4.8
Yield (%)	3.3	3.2	2.9	0.6	0.9
ROE (%)	28.7	32.1	45.8	35.4	29.3
ROCE (%)	26.1	14.3	12.6	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. Shandong Luoxin (Luoxin) is principally engaged in the development, manufacture and sale of prescription/OTC medicines under its own brands in four major categories of: 1) antibiotics; 2) anti-viral medicines; 3) system-specific medicines to treat digestive/cardiovascular/ respiratory ailments and 4) other chemical medicines, including anti-neoplastic medicines. Its principal production facilities are located in Linyi, Shandong.

What's new

- Luoxin recently announced 1H FY12/08A results. Turnover was up 36.3% YoY to RMB308.1m, while net profit surged 66.4% YoY to RMB85.6m. Gross margin improved 4.3 pcp YoY to 48.6%. The strong result suggests that the company would comfortably beat its previous guidance of RMB130m for FY12/08F.
- The growth was brought about by: 1) strong organic growth, from newly added production capacity and launch of new drugs. The improvement in gross margin was mainly due to product mix changes (in favour of the higher margin system specific medicines).
- Luoxin received SFDA product approvals for 7 new products in 1H FY12/08A. Management is aiming to obtain approvals for a total of 12 drugs for the whole of FY12/08. The continued strong pipeline of new drugs is impressive in our view given the tighter drug registration environment.

- In May 2008, the company acquired 20.0% of Qilu Medical Investment Management Co. for RMB19.6m. The medical equipment trading company recorded profit before tax of RMB5.2m and profit after tax of RMB2.4m and net asset value of RMB62.6m in 2007, representing P/B of 1.6x.
- Luoxin has still yet to receive approval for its H-share placement. The company recently extended the long stop date for its placing agreement from 30 Apr. 2008 to 30 Oct. 2008. In Nov 2007, the company announced that they intended to issue not more that 100m new H-shares, representing 16.5% of total issued share capital, at a price of between HK$2.60-3.60 per share.

Investment theme

- Luoxin is a vertically integrated pharmaceutical manufacturer producing from raw material bulk medicines to finished products. The company's nationwide network covers 27 provinces and four centrally-administered municipalities, and its clients include downstream distributors, hospitals and medical institutions, OTC market as well as bulk drug manufacturers. We estimate that the company derives about 1/3 of its revenues from Shandong Province and 1/5 from Guangdong.
- The company is a high growth company. Its 3-year CAGR between FY12/05A-07A is 42.8% in revenues and 81.8% for net profit. The growth was driven by aggressive drug launches and expanding capacity.
- Luoxin's next blockbuster drug is Rhodiola for injection. It is a herbal medicine product, which was granted a 20-year patent (in May 2006), for curing of cardiovascular diseases. The drug is awaiting SFDA drug registration licensing. Management estimates that it could generate RMB1.0b in revenue over its life cycle.

Risks

- Declining prices for raw material bulk medicine.
- Failure to obtain SFDA drug licensing for its Rhodiola for injection.
- Government regulations adversely affecting the pharmaceutical industry.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	**249.7**	**317.9**	**509.1**	**743.0**	**1,023.0**
Cost of sales	(144.3)	(175.9)	(260.6)	-	-
Gross profit	**105.4**	**142.0**	**248.5**	**-**	**-**
Other revenue	1.5	2.6	3.3	-	-
Other income	-	3.0	2.4	-	-
Selling and distribution expenses	(21.9)	(23.6)	(33.6)	-	-
Administrative expenses	(21.5)	(25.0)	(33.1)	-	-
Operating profit	**63.6**	**98.9**	**187.5**	-	-
Finance costs	(7.1)	(7.7)	(4.6)	-	-
Profit before tax	**56.4**	**91.2**	**183.0**	-	-
Tax	(19.5)	(31.0)	(61.0)	-	-
Profit after tax	**36.9**	**60.2**	**121.9**	-	-
Minority interest	-	-	-	-	-
Net profit	**36.9**	**60.2**	**121.9**	**285.0**	**391.0**

Source: Company data, Bloomberg Estimates

Tong Ren Tang Tech

Good brand, but no drivers

Not Rated

China Pharmaceuticals

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Our View

- We have seen that TRTT is currently short of a meaningful growth driver. Its 3 key products (accounting for about 45.0% of total revenue for FY12/07A) is expected to have a flat growth and secondary products are all coming off a sales based (most of them are less than RMB10.0m products) though several products are showing promising growth.
- TRTT is short of core competitive products even as it owns a famous time-honoured brand name. Its 3 main products have no patent protection and have multiple competitors in the market.
- We expect that TRTT's bottom line margin would be negatively affected by increasing marketing expenses used for maintaining current market share for its key products and promoting its secondary products.

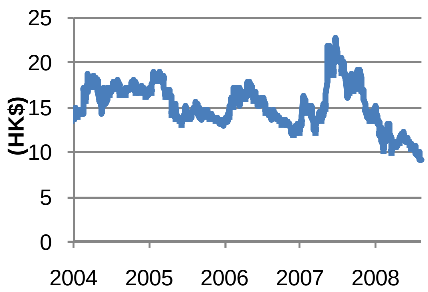
Stock data

Price	**HK$9.32**
Target price	N/A
12 mth range	HK$9.3-19.5
Market cap.	US$227.3m
Daily t/o, 3 mth	US$0.1m
Free float %	41.7%
Ticker	8069.HK/8069 HK

Financial summary

Year to Dec	**05A**	**06A**	**07A**	**08F**	**09F**
T/O (RMBm)	1,135.7	1,034.8	1,157.0	1,266.3	1,394.8
Net profit (HK$m)	231.2	148.3	153.5	173.3	209.8
EPS (HK$)	1.26	0.81	0.81	0.911	1.103
EPS Δ %	12.5	(35.7)	-	18.0	14.9
P/E (x)	7.4	11.5	11.5	10.2	8.5
P/B (x)	1.8	1.7	1.4	1.1	1.0
EV/EBITDA (x)	2.7	5.7	12.3	N/A	N/A
Yield (%)	5.5	2.0	0.5	5.6	6.3
ROE (%)	27.0	15.3	13.4	12.9	13.3
ROCE (%)	31.2	34.1	46.2	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. Tong Ren Tang Tech (TRTT) focus on manufacturing of Traditional Chinese Medicine (TCM). Tong Ren Tang Ltd. (600085 CH) holds 51.0% share of TRTT. TRTT manufactures 3 key products: (Liuwei Dihuang Pills (六味地黄丸), Niuhuang Jiedu Tablets (牛黄解毒片), Ganmao Qingre Granules (感冒清颗粒). Meanwhile, parent Tong Ren Tang manufactures products, such as Niu Huan Qing Xin Pills(牛黄清心丸), Wuji Baifeng Pills (乌鸡白凤丸), Dahuoluo Pills (大活络丸) and Guogong wine (国公酒). TRTT was listed on Hong Kong's GEM Board in 2000.

What's new

- TRTT's 1Q FY12/08A revenue increased 2.2% YoY to RMB319.6m while net profit dropped 10.1% YoY to RMB50.6m. Gross margin increased slightly 0.5 pcp to 42.9% while net margin decreased 2.1 pcp to 15.8%. The net margin was affected by: 1) distribution cost increased 14.5% YoY to RMB42.2m and 2) effective tax rate increased from 15.2% to 26.7%.
- The sales of 3 key products accounted for about 50% of TRTT's total revenue. However, the growth of these products is slow: 1) Liuwei Dihuang Pills (六味地黄丸) series increased by 1.8% YoY; 2) Niuhuang Jiedu Tablets (牛黄解毒片) series increased by 6.2% YoY and 3) Ganmao Qingre Granules (感冒清颗粒) increased about 15% YoY.
- TRTT has plans to move to HKEx Main Board and are currently preparing the submissions.

Investment theme

- TRTT's brand name "Tong Ren Tang" has some 338 years history in TCM.
- TRTT owns a rich product portfolio with 270 products (all SFDA approved). TRTT produces about 130 products in its current product line.
- Leverage the distribution network of its parent company. Tong Ren Tang group owns about 700 retail stores.

Risks

- Market competition give TRTT growth and margin pressure.
- Rising raw material price and labour cost give margin pressure.
- Regulatory risk associated with the pharmaceutical industry.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	**1,135.7**	**1,034.8**	**1,157.0**	**1,266.3**	**1,394.8**
Cost of sales	(560.9)	(577.2)	(661.2)	-	-
Gross profit	**574.8**	**457.5**	**495.8**	**-**	**-**
Selling and distribution costs	(220.8)	(179.9)	(185.3)	-	-
Administrative expenses	(97.4)	(104.3)	(125.9)	-	-
Operating profit	**256.6**	**173.3**	**184.7**	**-**	**-**
Financial costs	(4.6)	(2.0)	(4.9)	-	-
Share of result of an associated company	(0.1)	(0.1)	(0.4)	-	-
Pre-tax profit	**252.0**	**171.2**	**179.3**	**-**	**-**
Tax	(19.5)	(27.8)	(25.7)	-	-
Minority interests	(1.3)	4.9	(0.1)	-	-
Net profit	**231.2**	**148.3**	**153.5**	**173.3**	**209.8**

Source: Company data, Bloomberg Estimates

C&O Pharmaceutical

Cloudy outlook

HOLD (unchanged)

China Pharmaceuticals

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MICA (P) 156/10/2007
RCB. No. 200413424G

Our View

- C&O's outlook is increasingly cloudy, with rising raw material price pressuring margins and uncertainty in the outlook of its exclusive products distribution.
- Though the company has successfully signed strategic cooperation with several small/mid-sized foreign pharmaceutical companies, we do not expect them to make meaningful contribution any time soon. Moreover, the recent global credit tightening may increase the risk of working with these foreign partners.
- C&O lacks of meaningful growth driver in short-medium term and deserves to trade at a valuation discount to peers.
- We have a HOLD call on the counter, target price S$0.25, representing 6.0x FY6/09F P/E.

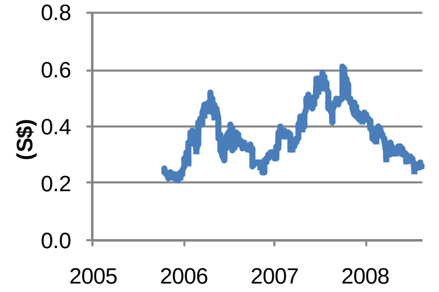
Stock data

Price	**S$0.26**
Target price	S$0.25 (-3.9%)
12 mth range	S$0.25-0.66
Market cap.	US$123.2m
Daily t/o, 3 mth	US$0.01m
Free float %	32.5%
Ticker	COPT SP

Financial summary

Year to Jun	06A	07A	08F	09F	10F
Turnover (HK$m)	347.4	680.0	593.8	712.8	803.4
Net profit (HK$m)	118.1	77.6	123.5	155.8	178.8
EPS (HK$)	0.202	0.124	0.186	0.235	0.270
EPS∆%	5.1	(38.7)	50.4	26.2	14.8
P/E (x)	7.3	12.0	8.0	6.3	5.5
P/B (x)	2.0	1.3	1.8	1.2	1.1
EV/EBITDA (x)	4.9	9.3	5.8	4.4	3.6
Yield (%)	5.0	-	-	4.8	5.5
ROE (%)	38..7	15.7	22.4	27.4	28.9
ROCE (%)	44.2	15.9	23.1	28.7	30.8
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. C&O pharmaceutical (C&O) is a Hong Kong based pharmaceutical holding company with operations in China. It mainly focuses on manufacture and distribution of generics. Its revenue is derived from three main sources: 1) sale of self-manufactured pharmaceutical products; 2) sale of third-party pharmaceutical products and 3) sale of technical know-how.

What's new

- C&O announced in 8th July 2008 that it has been appointed to be exclusive distributor for HELIXOR® A, an anti-cancer drug launched in 1972 in Germany, in China for a period of 10 years. It is expected that this drug will start sales in China in 2Q 2009.
- 3Q FY06/08's revenue was down 13.8% YoY and up 8.5% QoQ at HK$158.2m while net profit (excluding an one-off HK$6.9m gain) increased 15.3% YoY and 43.3% QoQ to HK$36.3m. The gross margin widened 16.1pcp YoY and 3.6 pcp QoQ to 51.7% and net margin 5.8pcp YoY and 5.5pcp QoQ to 22.9% (excluding the one-off gain). The strong YoY margin growth was a result of expanding margins of its own-branded and exclusive distribution products and lower contributions from low margin non-exclusive distribution products. Despite this, C&O's results came in below our expectations, with weaker-than-expected seasonal revenue growth this quarter.
- Sales of exclusive products decreased 2.6% YoY and 3.2% QoQ to HK$92.3m, while their gross margin widened 15.1 pcp YoY and 11.6 pcp QoQ to 61.3% thanks to RMB appreciation and higher sales of high-margin products. Sales of own branded products increased 31.7% YoY and 23.9% QoQ to HK$37.8m, with the gross margin up 1.3 pcp YoY but down 7.1 pcp QoQ at 63.3% because of rising raw material prices and declining ASPs. Sales of non-exclusive products decreased 52.8% YoY and increased 44.8% QoQ to HK$28.1m (gross margin down 0.9pcp YoY and 2.0pcp QoQ). Lower YoY sales in this low-margin segment was due to the company's disposal of its distribution subsidiary Shao Xing in 1Q FY06/08A.
- Shenzhen Liancheng Medicine company, a wholly-owned subsidiary of C&O, acquired another 10% of Sichuan Changao Medicine to be its 100% shareholder at cash consideration of RMB100,000.

Investment theme

- C&O currently owns 850 direct distributors and 1,100 indirect distributors covering over 116,000 clinics, pharmacies and hospitals across all parts of China.
- Expanding the product portfolio by cooperating with mid-sized foreign pharmaceutical companies: 1) Exclusive distribution rights of " Meiact" from Meiji Seika Kaisha Ltd (2202 JP); 2) Exclusive distribution of Pholcotussin cough syrup for children from Europharm and 3) Exclusive distribution of HELIXOR® A from Helixor Heilmittel GmbH & Co. KG.
- Expanding R&D capability by building new R&D center in Shanghai & Nanjing for developing contract research outsourcing (CRO) business.

Risks

- Uncertain timeframe to develop out its CRO business.
- Some of their foreign strategic partners may suffer from global credit tightening.
- Government regulation may adversely impact on the pharmaceutical industry.
- C&O is not significantly vertically integrated. Thus rising raw material and labour cost may significantly pressure margins.

Table 1: P&L

Year to Jun (HK$m)	06A	07A	08F	09F	10F
Turnover					
Sale of self-manufactured pharmaceutical products	75.8	105.8	132.9	166.5	199.8
Distribution ofimported products(exclusive products)	269.3	335.7	330.8	414.6	456.1
Sale of technical knowledge	2.2	7.0	0.9	1.0	1.1
Logistics distribution (Liancheng)	-	231.5	129.3	130.8	146.5
	347.4	**680.0**	**593.8**	**712.8**	**803.4**
Cost of sales	(179.3)	(467.5)	(312.3)	(360.4)	(407.9)
Gross profit	**168.1**	**212.4**	**281.6**	**352.4**	**395.5**
Other income and gains	3.8	2.9	10.1	2.5	2.8
Selling and distribution costs	(3.6)	(69.7)	(93.4)	(123.1)	(132.6)
Administrative expenses	(30.0)	(64.9)	(64.2)	(65.2)	(73.1)
Other operating expenses	(2.9)	(1.5)	(5.5)	(2.1)	(1.6)
Operating profit	**135.4**	**79.2**	**128.6**	**164.5**	**191.0**
Finance costs, net	-	(0.7)	(0.2)	(0.3)	(0.3)
Interest income	3.9	4.3	4.4	4.3	4.8
Profit before taxation	**139.3**	**82.9**	**132.8**	**168.5**	**195.5**
Taxation	(21.4)	(6.3)	(10.0)	(13.5)	(17.6)
Profit after tax	**117.9**	**76.6**	**122.8**	**155.0**	**177.9**
Minority interest	0.2	1.0	0.6	0.8	0.9
Profit attributable to shareholders	**118.1**	**77.6**	**123.5**	**155.8**	**178.8**

Source: Company data, SBI E2-Capital

China Nepstar

Store expansion galore

Not Rated

China Pharmaceuticals

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Stock data

Price	**US$8.45**
Target price	N/A
12 mth range	US$7.20-21.25
Market cap.	US$893.9m
Daily t/o, 3 mth	US$2.1m
Free float %	76.4%
Ticker	NPD.US/NPD US

Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (RMBm)	1,313.2	1,732.4	1,954.7	2,547.8	3,455.3
NP (RMBm)	(28.5)	(3.0)	133.0	313.8	449.0
EPS (RMB)	(0.250)	(0.030)	0.800	2.843	4.046
EPS Δ %	N/A	88.0	N/A	255.4	42.3
P/E (x)	N/A	N/A	72.2	20.3	14.2
P/B (x)	N/A	N/A	0.4	-	-
EV/EBITDA (x)	N/A	N/A	N/A	44.5	25.7
Yield (%)	N/A	N/A	N/A	9.5	5.5
ROE (%)	N/A	N/A	7.3	-	-
ROCE (%)	N/A	N/A	9.7	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart

Our View

- NPD appears to be able to execute aggressive store expansion strategy, but industry competition remains fierce, as indicated by company's inability to consistently grow same store sales (SSS). SSS grew 1.9% YoY to RMB3,947/day in FY12/07A, but contracted 3.0% YoY in 1Q FY12/08A.
- Margin improvement is through product mix change only. We expect margins for individual segments of private labels and centrally procured private labels to contract going forward due to rising raw material prices and inability to fully pass on price rise to consumers due to sustained competition.
- Store expansion strategy may not be able to sustain high growth rate in the long run as company exhausts opportunities in 1st and 2nd tier cities, gradually moving to 3rd tier cities.
- We expect roll out of favourable government regulations in the short to medium term to be mild and progressive, rather than one-off.

Company background. China Nepstar (NPD) is China's largest drugstore operator in terms of directly operated stores. The company had a nationwide network 2,249 drug stores spanning 73 cities at the end of Mar. 2008. Under the "Nepstar Drugstore" brand, NPD sells prescription and over-the-counter (OTC) drugs, nutritional supplements, traditional Chinese medicine herbs and other beauty care and healthcare products. The products are sold under both self-owned private labels and non-private lablels.

What's new

- Announced 1Q FY12/08A results. Revenue up 16.8% YoY to RMB542.7m, net profit up 304.4% YoY to RMB54.9m (incl. RMB35.5m interest income). Excluding interest income, net profit grew 42.9% YoY. Gross margin improved 10.0 pcp YoY to 47.8%.
- Main drivers of top and bottom line growth was the increase in number of drug stores and the improvement in product mix, with higher margin private label and centrally procured non-private label products accounting for 62.4% of overall revenues.
- Same store sales contracted 3.0% YoY. Management explained that this was due to the snow storms in February and its efforts to introduce and promote private label products.
- Acquired 68 drugstores from Ningbo New Century Medical (RMB30.0m cash consideration), 18 drugstores from Dongguan Ren Hui Tang Pharmaceutical (RMB2.3m cash consideration) and 42 drugstores from Qingdao Kangjie Chain Drugstore Co. (RMB16.8m cash consideration). Valuation represents 0.6x, 0.2x and 0.6x 2007 sales.

Investment theme

- NPD growth is driven by aggressive expansion. The company added 247 stores in 1Q FY12/08A and aims to add 1,050 in FY12/08A. Around 300-400 of these would be through acquisitions. The company targets 1st and 2nd tier cities for expansion. Company has earmarked RMB400m and RMB600m capex to fund expansion in FY12/08F and FY12/09F respectively.

- To drive gross margin growth, NPD plans to continue to improve product mix in favour of higher margin private label and centrally procured non-private label products. As at 1Q FY12/08A, gross margins for the respective lines are 73% (private labels), 63% (centrally procured non-private labels) and 20% (regional procured products).
- After launching its first private label product in Sep. 2005, company had 1,373 at end of 1Q FY12/08A. Revenue contribution increased to 23.6% in 1Q FY12/08A from 21.0% in 4Q FY12/07A and 18.3% in 3Q FY12/07A.
- Sales of drugs in China is still dominated by hospital pharmacies. However, the MoH has promulgated regulations requiring hospitals to allow prescriptions to be filled at non-hospital drugstores. This is beneficial for drugstore industry in China and promotes the development of drugstore chains. Industry is currently fragmented.
- Consolidating industry. In 2004, NDRC reported that 1,410 chain drugstores and 58,065 individual drugstores have obtained GSP certificates, offering consolidation opportunities for leading chain operators such as NPD.

Risks

- Slow down in consumer spending.
- NPD fails to find attractive acquisition targets.
- Company unable to effectively consolidate new acquisitions and unable to drive economies of scale.
- Counterfeit products may hurt NPD's brand and reputation.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover					
Prescription drugs	286.8	411.0	457.0	-	-
Over-the-counter	491.7	623.3	696.7	-	-
Nutritional supplements	248.5	311.6	357.8	-	-
TCM herbs	29.0	35.4	51.2	-	-
Others	257.1	351.2	392.0	-	-
	1,313.2	**1,732.4**	**1,954.7**	**2,547.8**	**3,455.3**
Cost of sales	(932.0)	(1,124.2)	(1,092.0)	-	-
Gross profit	**381.2**	**608.2**	**862.7**	**-**	**-**
Selling and distribution costs	(348.3)	(517.0)	(606.3)	-	-
Administrative expenses	(45.5)	(62.6)	(75.5)	-	-
Operating profit	**(12.6)**	**28.6**	**180.8**	-	-
Interest income	1.1	1.0	10.6	-	-
Investment income	(0.4)	1.0	1.1	-	-
Tax	(4.9)	(12.7)	(36.4)	-	-
Minority interests	(1.2)	(4.3)	(7.9)	-	-
Net profit	**(18.0)**	**13.6**	**148.2**	-	-
Accretion to Series A redeemable convertible preferred shares redemption	(10.6)	(16.6)	(15.1)	-	-
Net profit attributable to s/h	**(28.5)**	**(3.0)**	**133.0**	**313.8**	**449.0**

Source: Company data, Bloomberg Estimates

Simcere Pharma

Aggressive M&A strategy

Not Rated

China Pharmaceuticals

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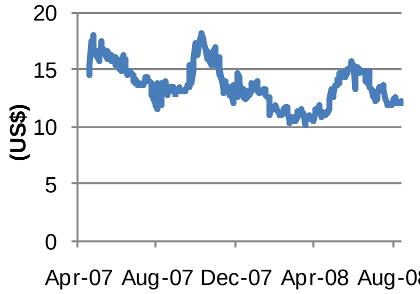
Stock data

Price	**US$12.1**
Target price	N/A
12 mth range	US$9.98-19.3
Market cap.	US$766.9m
Daily t/o, 3 mth	US$1.1m
Free float %	92.9 %
Ticker	SCR.US/SCR US

Financial summary

Year to Dec	05A	06A	07A	08F	09F
Turnover (RMBm)	737.1	950.6	1,389.3	1,830.4	2,349.7
Net profit (RMBm)	102.7	172.3	301.3	386.8	467.3
EPS (RMB)	N/A	N/A	4.8	6.2	7.5
EPS(△%)	N/A	N/A	N/A	29.2	21.0
P/E (x)	N/A	N/A	16.7	13.5	11.0
P/B (x)	N/A	N/A	6.4	3.1	2.5
EV/EBITDA (x)	N/A	N/A	N/A	12.3	7.7
Yield (%)	N/A	N/A	N/A	-	-
ROE (%)	65.8	54.2	24.8	20.1	17.7
ROCE (%)	29.2	31.4	22.4	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Our View

- End of patent protection period for several products (excluding Endu) may subject SCR to more competition and price pressure going forward.
- 4 M&As in past one year have expanded SCR's product portfolio and moved it from focus on branded generic drugs to first-to-market generic and innovative medicine with a particular concentration in anti-cancer and anti-stroke drugs.
- Rich cash position and professional screening team (20 people for screening M&A projects and 10 people for screening R&D projects) could benefit SCR for catching M&A opportunities.
- Restructuring the promotion strategy of some products, such as Endu and Yidasheng would bring uncertainty to SCR's revenue and profit growth.
- We have neutral view on SCR given the concern for the efficiency of restructuring its product portfolio, although we believe that SCR could rapidly expand its product pipeline through various M&As.

Company background. Simcere pharmaceutical (SCR) was previously a manufacturer and exclusive distributor of branded generic drug. It has since transformed itself to a first-to-market generic and innovative drug manufacturer through aggressive M&As in 2007. Its current key products include Endu (恩度) (anti-cancer drug), Bicun (必存) and Yidasheng (易达生) (anti-stroke drug), Zailin (再林) and Anqi (安奇) (amoxicillin antibiotics) ,Yintaiqing (英太青) (anti-inflammation drug) and Biqi (必奇) (anti-diarrhea drug). SCR was listed in NYSE in Apr. 2007.

What's new

- 2QFY12/08A revenue increased 30.4% YoY to RMB436.2m while net profit increased 14.5% YoY to RMB95.2m. The gross margin decreased 3.3 pcp YoY to 81.7% while the net margin 3.3pcp YoY to 21.8%.
- The sales of Endu increased only 4.6% YoY to RMB63.1m, which is lower than SCR's expectation due to restructuring of Endu's sales force. The sales of Bicun and Yidasheng increased 34.3% YoY to RMB147.6m. Sales of other generic products increased 34.2% YoY to RMB160.2m.
- Biapenem injection under the brand name Anxin for treating serious infection received SFDA approval in May 2008 and is expect to launch soon. SCR aims to launch one more new product in 2008.
- Management revised down its top line guidance to around 32.1% YoY increase to RMB1,800.0m (from previously RMB2,000.0m) but maintain its bottom line guidance around 30.0% YoY increase to about RMB390.0m for FY12/08F. The guidance for sales of Endu was revised down to 20.0% growth (from 40.0%-50.0% growth). Sales guidance of Bicun & Yidasheng was revised up to 50.0% growth (from 80.0%).

Investment theme

- SCR owns around 1,500 in-house and outsourced sales professionals in China specializing in neurology, oncology and cerebrovascular promotion. It has 1,500 distributors covering 2,000 hospitals and over 70,000 retail pharmacies.
- 4 acquisitions since IPO: 1) 10.0% more interest in Shandong Simcere Medgenn (the manufacturer of Endu) to increase it share in this company to 90.0%; 2) 51% stake in Boda Pharmaceutical (manufacturer of anti-stroke drug Yidashen); 3) 85.7% of Nanjing Tung Chit Pharmaceutical (manufacturer of anti-cancer drugs) and 4) acquired 70% of Wuhu Zhong Ren Pharmaceutical (manufacturer of anti-cancer drugs).
- SCR currently has RMB949.0m cash and RMB340.0m bank notes at hand, representing US$3.0 per share.

Risks

- Rapid M&A strategy would bring consolidation risk to the company.
- Government regulation adversely affecting the pharmaceutical industry.
- Competition from foreign drug manufacturer.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	**737.0**	**950.6**	**1,389.3**	**1,830.4**	**2,349.7**
Cost of sales	(171.1)	(190.6)	(241.1)	-	-
Gross profit	**565.9**	**760.0**	**1,148.2**	**-**	**-**
Research and development expenses	(16.3)	(34.3)	(68.3)	-	-
Selling and distribution costs	(312.4)	(442.8)	(634.4)	-	-
Administrative expenses	(87.1)	(98.2)	(161.1)	-	-
Operating profit	**150.1**	**184.8**	**284.4**	**-**	**-**
Interest Income	0.9	2.8	24.4	-	-
Interest expense	(15.0)	(10.7)	(6.3)	-	-
Foreign currency exchange gain	-	-	24.7	-	-
Pre-tax profit	**136.0**	**176.9**	**327.1**	**-**	**-**
Tax	(32.5)	(7.0)	(13.5)	-	-
Minority interests	(0.8)	2.3	(12.3)	-	-
Net profit	**102.7**	**172.3**	**301.3**	**386.8**	**467.3**

Source: Company data, Bloomberg Estimates

China Medical Devices

Mingyuan Medical

New growth drivers emerging

Not Rated

Our View

- Strategic cooperation with GE (China) to develop China's healthcare market is a major breakthrough. We expect more details sometime towards end Aug. 2008.
- MY has reduced its reliance on its C-12 protein chip by adding the distribution of HPV DNA test kits and TB protein chip (once SFDA approval is obtained) to its product portfolio. This will: 1) diversify revenue streams and 2) infuse MY with new growth drivers.
- Incorporation of its cancer marker into CLS' Cancer Care Insurance Policy shows great promise, particularly given the untapped opportunities of China's health insurance market. Appointment of Ma Yong Wei (one of China Life's INEDs) as non-executive director further strengthens ties between both companies.
- We like MY as the company appears to have set up the value chain for many of its growth drivers going forward. Moreover, it has a unique positioning as a peripheral insurance-related play. Value is emerging. The counter is currently trading at 21.8x FY12/07A and 16.1x FY12/08F P/E on consensus. Mingyuan traditionally trades at between 26.0-32.0x historical P/E.

China Medical Devices

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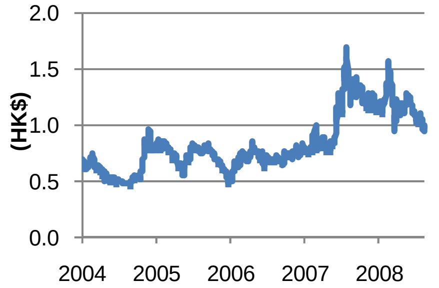
Stock data

Price	**HK$0.98**
Target price	N/A
12 mth range	HK$0.88-1.60
Market cap.	US$360.0m
Daily t/o, 3 mth	US$0.7m
Free float %	43.6%
Ticker	0233.HK/233 HK

Financial summary

Year to Dec	**05A**	**06A**	**07A**	**08F**	**09F**
Turnover (HK$m)	127.0	160.8	256.5	347.3	448.3
Net profit (HK$m)	70.0	73.6	125.3	199.3	258.0
EPS (HK$)	0.026	0.027	0.045	0.061	0.082
EPS ∆ %	4.4	3.8	66.7	35.6	34.4
P/E (x)	37.7	36.2	21.8	16.1	12.0
P/B (x)	5.4	4.7	3.4	2.9	2.4
EV/EBITDA (x)	15.8	21.4	23.2	15.2	11.7
Yield (%)	N/A	2.6	1.8	3.1	4.3
ROE (%)	16.0	13.9	18.0	20.5	23.5
ROCE (%)	17.3	13.0	17.8	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. Listed on the HKEx in Sep. 2002, Mingyuan Medicare Development Company Limited (MY) is a Hong Kong-based pharmaceutical holding company operating in China. It derives revenue mainly from: 1) sales of C-12 protein chips to 600 hospitals and wholesale distributors and 2) sales of human papilloma virus (HPV) cancer screening kits, manufactured and distributed in China. The company has its own R&D division and two factories near Shanghai.

What's new

- Company announced in Jul. 2008 that it has entered into a strategic cooperation memorandum to GE (China) Co. Ltd. Healthcare to jointly develop medical and diagnostics centres in China.
- GE (China) Co. Ltd. Healthcare is the arm of GE Healthcare in China, which in turn, is a US$17b unit of General Electric Co. (GE US). Under the strategic cooperation memorandum, MY and GE China would build up a network of medical and diagnostic centres in China for the provision of "Early Health" services including early screening for major diseases using biomedical servicing kits, X-Rays, digital mammography, computed tomography and MRI technologies etc.
- MY also recently announced that they will participate in a national research project in China for the standardization of tumour markers.
- Company appointed Mr. Ma Yong Wei as a non-executive director. Mr. Ma is also an independent non-executive director of China Life (2628 HK).

- MY has completed the development of its protein chip for the early stage detection of tuberculosis (TB), one of the most infectious diseases worldwide. The company has commenced the drug licensing process with the SFDA and it is currently expected that final approval should be obtained in 2009.

Investment theme

- MY's C-12 protein chip is the only tumor marker to detect for multiple types of cancer simultaneously. Capable of detecting up to 12 tumor markers at the same time, C-12 protein chips can assist in the detection of 10 cancers at their asymptomatic stage. The C-12 protein chip commands a gross margin of around 80%.
- MY's indirect 51%-owned subsidiary Shanghai Weiyi Hospital Investment and Management Co. Ltd (Weiyi), a 228-bed woman and infant specialty hospital in Shanghai, has a 20-year agreement (starting in June 2006) with Genetel Pharmaceuticals Limited (Genetel), a subsidiary of City University of Hong Kong (City U) to exclusively distribute DNA HPV diagnostic tests in Asia Pacific and China. Weiyi was acquired in Jun 2006 for RMB60.0m.
- China Life deal further strengthens distribution network. MY signed a cooperation agreement with China Life Insurance Company Limited, Shanghai Branch (CLS) in Dec 2006. CLS will package MY's C-12 protein chip into their "Cancer Care Insurance" product. The insurance product was launched in Shanghai in early Apr 2007 and will be gradually scaled up to be distributed nationwide. For each policy sold (RMB450/year), MY will supply one proprietary protein chip as part of the health evaluation process prior to the acceptance of the policy application. With the proliferation of insurance products in China, we expect MY Medicare to benefit substantially from this partnership.
- FY12/07A turnover was up 59% YoY to HK$256.5m. Operating profit rose a similar 58% YoY to HK$150.3m with net profit surging 70% YoY to HK$125.3m. The stronger bottom line increase was due to a lower effective tax rate of 15% in FY12/07A (FY12/06A: 20%) and the recording of losses from discontinued operations amounting to HK$3.2m in FY12/06A. The results came in ahead of market estimates.
- Sales MY's core C-12 protein chips was HK$219.0m, up 45.0% YoY. It sold 2.2m chips, representing a 46.0% increase YoY. Both the sales volume jump and stable ASP surprised on the upside. Segment margins for the segment improved by 7.4 pcp to 83.7%.
- Healthcare division improved its revenues by 276.0% to HK$37.4m but segment profit fell to HK$0.6m from HK$1.1m a year ago as the company incurred start up expenses for its HPV DNA testing kits. MY appointed distributors in 9 provinces and two municipalities including Beijing and Shanghai and have also obtained approvals to sell in over 57 hospitals in China. According to management, Mingyuan sold over 25,000 kits in FY12/07A.

Risks

- Reliance on CLS to market its cancer insurance policy to sustain growth of C-12 protein drug.
- Failure to ramp up its strategic cooperation with GE (China).
- Accuracy of protein markers for use in early detection of diseases.
- Risk arising from government regulation.

Table 1: P&L

Year to Dec (HK$m)	05A	06A	07A	08F	09F
Turnover	**127.0.**	**160.8**	**256.5**	**347.3**	**448.3**
Cost of sales	(11.7)	(19.5)	(43.0)	-	-
Gross profit	**115.2**	**141.3**	**213.5**	**-**	**-**
Other income and gains	23.4	20.6	30.7	-	-
Selling and distribution costs	(5.8)	(9.2)	(15.9)	-	-
Administrative expenses	(42.0)	(43.6)	(68.6)	-	-
Other operating expenses	(13.7)	-	-	-	-
Finance costs	(5.0)	(16.7)	(9.6)	-	-
Gain on disposal/dissolution of subsidiaries	-	2.6	0.2	-	-
Profit before taxation	**72.1**	**95.1**	**150.3**	**-**	**-**
Taxation	-	(19.0)	(23.4)	-	-
Profit after tax	**72.1**	**76.1**	**126.9**	**-**	**-**
Loss attributable to discontinued activities	(2.1)	(3.2)	-	-	-
Minority interests	(0.1)	0.6	(1.6)	-	-
Profit attributable to shareholders	**70.0**	**73.6**	**125.3**	**199.3**	**258.0**

Source: Company data, Bloomberg Estimates

Golden Meditech

Spinning-off again

Not Rated

Our View

- The spin-off of the cord blood bank business, the stocks' key short term catalyst, remains uncertain in terms of both timing and valuation.
- Though Meditech has consistently realised gains from spin-off listing (China Medical Technologies (CMED US)) and introduction of strategic investors to its various medical divisions, the counter nearly always trades at a valuation discount to peers.
- The investment community's reluctance to reward the company with a significant valuation re-rating reflects investors view that Meditech is essentially a medical investment holding company with a maturing medical device business.
- Given its track record, we also expect Meditech to eventually introduce strategic investors into its newly acquired hospital division, positioning for an eventual spin-off.
- Ramp up of new products in its medical devices segment is likely to be long. Therefore, growth in this segment should be moderate in the near term, at single digits. Most of the growth is likely to come from sales of consumable plastic chambers for the ABRS. Revenues from this sub-segment grew 17.0% in FY3/08A to HK$58.9m.

China Medical Devices

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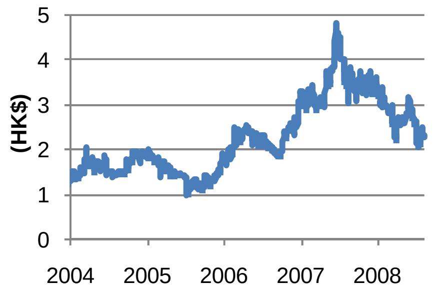
Stock data

Price	**HK$2.38**
Target price	N/A
12 mth range	HK$2.00-3.84
Market cap.	US$468.4m
Daily t/o, 3 mth	US$0.8m
Free float %	37.9%
Ticker	8180.HK/8180 HK

Financial summary

Year to Mar	06A	07A	08A	09F	10F
Turnover (HK$m)	280.6	331.1	421.1	628.0	656.0
Net profit (HK$m)	563.8	223.4	683.7	336.5	369.0
EPS (HK$)	0.445	0.170	0.377	0.220	0.240
EPS Δ %	N/A	(61.8)	122.0	(41.6)	9.0
P/E (x)	5.2	13.6	6.2	10.5	9.6
P/B (x)	1.5	1.4	1.1	1.2	1.1
EV/EBITDA (x)	26.6	22.8	15.3	9.1	7.6
Yield (%)	N/A	1.0	N/A	1.8	2.1
ROE (%)	37.4	9.7	23.6	10.9	10.9
ROCE (%)	70.2	24.3	57.4	-	-
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Chart



Company background. Golden Meditech (Meditech) operates in four major businesses focusing on: 1) sale of medical devices and personal healthcare products; 2) cord blood bank services; 3) sales of Chinese herbal medicines and 4) healthcare industry investment. Its flagship device, autologous blood recovery system (ABRS), is used in some 2,300 rated hospitals in China and management estimates that it has an 80% market share. For its cord blood bank division, Meditech is engaged in the separation, processing, and storage of umbilical cord blood stem cells from newborns. The company possess 2 (Beijing and Guangdong) of the 6 exclusive licenses granted by the government.

What's new

- In Jun 2008, Meditech announced the acquisition of a hospital management company and the Daopei Hospitals Group. Located in Beijing and Shanghai, the group is the China's largest private specialist hospital in haematology, leukemia treatments and stem cells transplant.
- The acquisition consideration of HK$830.0m comprises HK$50.0m in shareholder's loan and HK$780.0m in sales shares. The acquisition contains guaranteed profits of HK$40.0m and HK$70.0m in the first two years, representing a valuation of 32.5x and 18.6x respectively.
- With the opening of the company's cord blood bank facility in Guangdong in May 2007, revenue surged 115.5% YoY to HK$137.8m in FY3/08A, while operating margins jumped 6.3 pcp to 45.6%. Over 26,000 new users, up 111.0% YoY during the financial year. At the end of Sep. 2008, the two centres had a total of over 45,000 subscribers.

- According to the management, spin-off of the cord blood bank segment for listing on an overseas stock market (most likely NASDAQ) is on track. The company has undertaken with other investors of the cord blood bank subsidiary to list the entity by Nov. 2008. Meditech currently holds 50.25% in the subsidiary.

Investment theme

- Meditech is an integrated medical equipment and healthcare services provider. The company's leading market share in its ABRS products generates strong cashflow, allowing it to both grow out new business and enter into new markets, such as specialist hospital operations (via the acquisition of Daopei Hospitals Group).
- There are substantial opportunities in its cord blood bank segment. The company's new subscriber sign-ups had been growing at a CAGR of 139% between FY3/04 to FY3/08. Recently opened Guangdong centre will further provide a strong growth driver for the segment. It contributed new 7,600 new subscribers in only 4 months of operations. At around 1,100,000 per year, the yearly birth rate in the Guangdong Province is more than 10x that of Beijing. The spin-off of this segment should unlock value in the company.
- After the merger and reorganisation of its natural herbal medicines segment with China Healthcare Inc (CHI) in Dec. 2007, Meditech has effectively gained access to the healthcare sector in Europe. CHI is one of the largest retail chains of alternative healthcare products in England and Ireland. The associate company currently has a network of around 90 stores and it plans to grow that out to 200 this financial year. Meditech currently holds 40.0% of CHI.
- The medical devices segment continues to enjoy steady growth. Revenues grew 6.0% YoY in FY3/08A to HK$283.3m. Operating margins was relatively steady 70.9% down 0.5 pcp YoY. As the product is a mature product, it does not incur significant SG&A costs. Meditech plans to re-ignite long term growth in the sector through the introduction of its 3000H Product Plasma Exchange System and its HS-9000 Thermostatic Infusion Group. Both devices has already obtained SFDA approvals.

Risks

- Regulatory risk relating to its cord blood bank business.
- Failure of the company to successfully spin-off its cord blood bank business.
- Regulatory risk relating to hospital operations and ownership.

Table 1: P&L

Year to Mar (HK$m)	06A	07A	08A	09F	10F
Turnover	**280.6**	**331.1**	**421.1**	**628.0**	**656.0**
Cost of sales	(92.4)	(96.6)	(122.0)	-	-
Gross profit	**188.1**	**234.5**	**299.1**	**-**	**-**
Other revenue	22.2	44.7	64.2	-	-
Other net income	(0.1)	73.0	332.4	-	-
Selling and distribution costs	(14.0)	(18.0)	(33.0)	-	-
Administrative expenses	(98.8)	(78.4)	(127.4)	-	-
Operating profit	**97.4**	**255.8**	**535.3**	-	-
Finance costs	(12.4)	(10.8)	(20.6)	-	-
Gain on deemed disposal of interests in associate/JCEs	116.6	-	55.4	-	-
Gain on partial disposal of an associate	322.2	-	-	-	-
Share of profits of associates/JCEs	40.0	35.6	68.7		
Profit before tax	**563.7**	**280.6**	**638.8**	-	-
Tax	(2.5)	(15.8)	(24.2)	-	-
Profit from continuing operations	**561.3**	**264.8**	**614.5**	-	-
Discontinued operations	-	(34.1)	99.1	-	-
Profit for the year	**561.3**	**230.7**	**713.7**	-	-
Minority interests	2.6	(7.3)	(29.9)	-	-
Net profit	**563.8**	**223.4**	**683.7**	**336.5**	**369.0**

Source: Company data, Bloomberg Estimates

Shandong Weigao

High growth momentum sustained

Not Rated

China Medical Devices

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Our View

- Weigao continues to be one of our top conviction buy calls in China's medical equipment sector. We like the company's dual strategy of: 1) progressively moving into manufacture and sales high-end products (previously mostly supplied by foreign medical equipment companies) in 1st tier cities and 2) distribution network expansion in 2nd tier cities. JVs and other business cooperation efforts with 15.0% shareholder Medtronic Inc. (MDT US) provides further potential upside.
- More stringent government inspection and rising raw material costs has forced low quality and other small scale medical equipment manufacturers out of the market. This consolidation has further strengthened Weigao's leadership position.
- Consumable medical products have been the cash cow underpinning Weigao's transition to the manufacture of high end products such as artificial joints and trauma products. Sales of consumable medical products were up 37.2% YoY to RMB849.7m in FY12/07A, accounting for 77.6% of its total sales.
- With leadership position and sustaining growth momentum, Weigao's fundamental are intact. We see value emerging. At 33.1x historical P/E, the counter is trading at the low end of its 2-year P/E band of 28.9 – 48.0x while maintaining historical growth rates. In forward valuation terms, the company is trading at 25.6x and 19.6x FY12/08F and FY12/09F P/E on consensus.

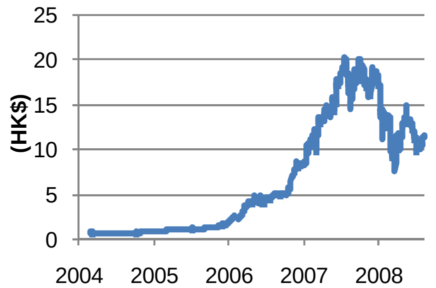
Stock data

Price	**HK$11.40**
Target price	N/A
12 mth range	HK$7.32-21.30
Market cap.	US$1440.0m
Daily t/o, 3 mth	US$1.6m
Free float %	31.4%
Ticker	8199.HK/8199 HK

Financial summary

Year to Dec	05A	06A	07A	08F	09F
Turnover (RMBm)	570.0	786.9	1,095.1	1,499.7	2,210.4
Net profit (RMBm)	101.2	170.9	308.1	510.6	782.0
EPS (RMB)	0.110	0.180	0.310	0.401	0.524
EPS	37.5	63.6	72.2	29.4	30.7
P/E (x)	93.2	57.0	33.1	25.6	19.6
P/B (x)	17.4	14.2	7.7	4.2	3.2
EV/EBITDA (x)	16.3	47.4	59.6	33.4	21.8
Yield (%)	1.7	0.6	0.6	0.6	1.1
ROE (%)	21.7	27.0	30.4	24.6	23.9
ROCE (%)	18.3	23.4	29.0	-	-
N. Gear. (%)	40.4	48.6	17.5	18.3	10.5

Price Chart



Company background. Shandong Weigao (Weigao) is leading medical devices manufacturer in China. Weigao manufactures: 1) consumable medical products, including syringes, blood bags, infusion sets, dental and anesthetic products, and blood sampling products; 2) Orthopaedic products; 3) blood purification consumables, drug-eluted stents (DES) and PVC granules. Weigao was listed in HK GEM in Feb. 2004. Medtronic Inc. (MDT US) acquired 15.0% equity interest in Weigao for HK$1.7b in Dec 2007.

What's new

- Weigao's 2Q FY12/08A revenues increased 54.1% YoY to RMB394.8m while net profit increased 70.9% YoY to RMB114.3m. Gross margin increased 3.2pcpYoY to 47.1% while the net margin increased 2.8 pcpYoY to 28.9%.
- 2QFY12/08A growth was mainly driven by the sales of infusion sets and needles, which increased by 44.7% YoY to RMB91.6m and 103.2% YoY to RMB57.1m respectively. The sale of high value-added products (margin>60.0%) has increased from 41.9% of total revenue in 1Q to 43.1% of total revenues, which indicates that Weigao is successfully moving up the value chain and into higher end products.
- Management is seeing stronger demand for its products in the coming years and guided more than 50.0% net profit growth.

- 3Q sales may be slightly affected by Olympics as the hospitals in Olympic cities will reserve some position for emergency use during the Olympic game period, which would lead to lower utilisation and demand for Weigao's products, particularly for Drug Eluting Stents in its JV.
- Progress with coming projects: 1)Weigao expects to start trial productionof its blood purification consumables products in Sep. 2008 (1.7m set capacity) and 2) JV with Medtronics would be expected to start in Sep. 2008.
- We believe that there is increasing likelihood of terminating the deal of selling remaining 50% of JW Medical System to Biosensors in exchange for 13.2% of Biosensors shares, due to difficulties in obtaining CSRC regulatory approval.

Investment theme

- Weigao has a wide customer base. By the end of 2Q FY12/08A, it had a distribution network of 2,817 hospitals, 413 blood stations, 689 other medical units and 1,471 distributors. It covered 80.2% of 1sttier hospitals, 23.9% of 2ndtier hospitals and 6.1% of 3rdtier hospitals in China.
- Weigao has competitive advantage with its established reputation as a leading quality medical device manufacturer among Chinese medical device manufacturers and low cost advantage comparing to overseas branded medical device manufacturers.
- Long-term benefit from close corporation with Medtronic. 1) technology transfer of Medtronic's medical device technology and tapping into global market by undertaking OEM for Medtronic orthopaedic medical device products; 2) 49:51 JV with Medtronic (expect to be start in Sep. 2008) will distribute exclusively several of Metronic's orthopaedic medical device products in the PRC.
- Weigao has kept at a high growth level for past three years. (top line grew at a three year CAGR 39.0%, bottom line grew at a three year CAGR 67.2%).

Risks

- Implementation of centralized government tender program will give Weigao pressure.
- Execution risks arising from its potential M&As and new JV with Medtronic.
- Irrational pricing pressure from competitors.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	**570.0**	**786.9**	**1,095.1**	**1,499.7**	**2,210.4**
Cost of sales	(335.7)	(451.6)	(594.8)	-	-
Gross profit	**234.3**	**335.3**	**500.3**	**-**	**-**
Other net (loss)/income	14.8	18.2	31.5	-	-
Selling and distribution costs	(87.4)	(115.4)	(152.7)	-	-
Administrative expenses	(40.1)	(59.8)	(88.0)	-	-
Operating profit	**121.6**	**178.3**	**291.1**	**-**	**-**
Financial costs	(17.0)	(21.5)	(17.9)	-	-
Share of loss of a jointly controlled entity	(1.5)	32.5	59.0	-	-
Share of loss of an associate	(0.5)	-	-	-	-
Pre-tax profit	**102.6**	**189.3**	**332.1**	**-**	**-**
Tax	(0)	(6.7)	(2.7)	-	-
Minority interests	(1.4)	(11.7)	(21.2)	-	-
Net profit	**101.2**	**170.9**	**308.1**	**510.6**	**782.0**

Source: Company data, Bloomberg Estimates

Mindray Medical

Home and overseas growth

Not Rated

China Medical Devices

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Our View

- Sustained high growth makes MR an attractive medical device manufacturer. The future growth would be driven by: 1) increasing government spending on medical infrastructure in China, broader coverage of medical insurance, and increasing aged population; 2) slow down of U.S & European economies driving demand for MR's product which could meet the stringent quality/regulatory demands and yet sell in comparatively lower price than global giants.
- Benefiting from acquisition of Datascope in the US via: 1) combination of cost advantage of MMI and Datascopes' US distribution network; 2) complimentary R&D capability with MMIs' strength in hardware/manufacturing design and Datascopes' strength in software and UI design.
- Solid management foundation adds credibility to MR: 1) key management has significant experience in the medical device industry; 2) core staff is suitably incentivised to perform.
- MR traditionally trades at a valuation premium to its peers. It is currently trading at 32.3x FY12/08F P/E and 21.8x FY12/09F P/E, which is 26.2% and 11.2% premium on Shandong Weigao (8199 HK), another high growth Chinese medical device manufacturer listed on the HKEx.

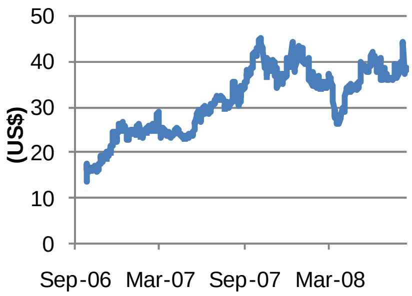
Stock data

Price	US$44.04
Target price	N/A
12 mth range	US$24.97-45.19
Market cap.	US$4,019.3m
Daily t/o, 3 mth	US$30.9m
Free float %	71.9%
Ticker	MR.US/MR US

Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (RMBm)	1,078.6	1,515.0	2,230.9	3,902.4	5,686.5
NP (RMBm)	205.1	361.8	591.6	997.8	1,479.9
EPS (RMB)	N/A	3.750	5.250	9.250	13.700
EPS Δ %	N/A	N/A	40.0	76.2	48.1
P/E (x)	N/A	93.7	63.8	32.3	21.8
P/B (x)	N/A	16.6	12.6	8.8	6.6
EV/EBITDA (x)	N/A	42.1	47.0	26.0	17.8
Yield (%)	N/A	N/A	0.4	0.6	0.9
ROE (%)	N/A	29.5	24.1	30.3	32.0
ROCE (%)	N/A	25.5	23.6	-	-
N. Gear. (%)	cash	cash	cash	cash	cash

Price Chart



Company background. Mindray Medical International Limited (MR) is a China based medical devices manufacturer and distributor. It offers about 50 products across three product segments internationally: 1) patient monitoring and life support products, 2) in-vitro diagnostic products, and 3) medical imaging systems. It was listed on NYSE on 2006. MMI acquired US based Datascope's patient monitoring device business for US$209.0m in cash in May 2008.

What's new

- 1Q FY12/08A revenue increased 48.2% YoY to RMB626.0m while net profit increased 46.6% YoY to RMB179.4m. Sales in China increased by 46.9% YoY to RMB306.4m and sales in other areas increased by 49.4% YoY to RMB319.6m. The gross margin increased 0.4 pcp YoY to 56.5% while the net margin decreased 0.3 pcp YoY to 28.7%. The drop in net margin was due to the effective tax rate increasing from 15.7% to 18.5%.
- MR completed the acquisition of Datascopes' patient monitoring device business in May 2008 for US$209m in cash (adjusted for working capital at the closing date), which represents 1.3x FY12/07A revenue. However, MR doesn't expect net profit contribution from Datascope's patient monitoring business for FY12/08F as it is still in breakeven stage at the moment.
- MR launched 2 new products in China and obtained 3 new FDA approvals in 1Q FY12/08A. It plans to launch 5 new products for the remaining of 2008.
- Capex plan is US$90m-100m for building manufacturing and R&D centre in Shenzhen and Nanjing.

- MR management guided a 43-47% YoY growth in the bottom line for FY12/08F including the consolidation of Datascope's patient monitoring device business starting from May 2008.

Investment theme

- MR owns a wide distribution network over the world with 1,000 sales, 900 exclusive distributors and more than 1,000 non-exclusive distributors in China and works with over 1,600 distributors overseas to sell its product to over 140 countries.
- MR has a strong R&D focus with 1,200 R&D staff in Shenzhen, Mahwah, Beijing and Seattle and R&D budget of about 10% of its total revenue (RMB215.2m in R&D for FY12/07A).
- Diversified geographical revenue base with high growth. Revenue increased in 4-years CAGR 48.4%. China area increased in 4-year CAGR 33.5%, North America area increased in 4-years CAGR 44.0%, Asia area (excl. China) increased in 4-years CAGR 44.0%, European area increased in 4-years CAGR 91.2% and other areas increased in 4-years CAGR 108.7%. The management expect 43-47% bottom line growth for FY12/08F.
- Leading market position for its core products in China: 1) MR accounted for 40.4% market share for patient monitoring devices competitors while Philips accounted for 18.4% and GE accounted for 13.5%; 2) MR accounted for 43.1% in 3-Part Hematology Analyzer while comparables Sysmex accounted for 14.4% and Tecom accounted for 11.4%; 3) MR accounted for 27.8% in Black/White Ultrasound while GE accounted for 13.5% and Siemens accounted for 7.1%.
- Keeping cost advantage by vertically integrated production line, in particular the core parts for its equipment. According to management, only 5% of its upstream product in its cost structure is outsourced.

Risks

- Slow down of world economy could drive the consumption of medical device down.
- Risk arising from consolidation with Datascope.
- Risk arising from government regulation.
- A significant escalation in market competition.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover					
China	627.0	779.4	1,102.9	-	-
Asia(excl. China)	181.1	220.3	300.2	-	-
Europe	135.6	259.4	409.6	-	-
North America	69.1	120.1	151.7	-	-
Other	65.8	135.7	266.4	-	-
	1,078.6	**1,515.0**	**2,230.9**	**3,902.4**	**5.686.5**
Cost of sales	(493.3)	(687.5)	(1,006.5)	-	-
Gross profit	**585.2**	**827.5**	**1,224.5**	**-**	**-**
Selling and distribution costs	(146.5)	(211.9)	(311.4)	-	-
Administrative expenses	(112.1)	(76.0)	(91.1)	-	-
Research and development expenses	(106.1)	(149.1)	(215.2)	-	-
Expense of in-progress R&D	-	(31.8)	-	-	-
Other general expenses	-	0.2	(0.2)	-	-
Operating profit	**220.5**	**358.9**	**606.6**	**-**	**-**
Other income	9.5	8.5	19.9	-	-
Other expenses	(0.3)	(2.5)	(2.0)	-	-
Interest income	3.9	27.9	73.7	-	-
Interest expense	(2.0)	(0.5)	(0.1)	-	-
Pre-tax profit	**231.6**	**392.3**	**698.1**	**-**	**-**
Tax	(18.1)	(24.1)	(106.5)	-	-
Minority interests	(8.4)	(6.5)	-	-	-
Net profit	**205.1**	**361.8**	**591.6**	**997.8**	**1,479.9**

Source: Company data, Bloomberg Estimates

China Healthcare

China Renji

Specialist market leader

Not Rated

China Healthcare

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Our View

- We like Renji for: 1) its positioning as a specialist healthcare services provider; 2) large market share in 1st tier cities such as Shanghai and Beijing and 3) M&A led strategy.
- Partnerships with Grade 3A hospitals ensure access to large catchment areas and steady stream of patients.
- Renji's frontline health check services act as a driver for the business, funnelling additional cancer patients into Renji's treatment centres. It also allows for the development of after-treatment services.
- Company generates strong revenues, profitability and cashflow, though this is weighed down by non-cash items such as intangible amortisation, derivative finance costs and stock option expenses.
- We expect Renji to announce one more, possibly significant, acquisition within FY12/08. Thus far in FY12/08, company has acquired 6 medical centres.
- Renji's business model is superior to traditional healthcare plays such as Hua Xia (8143 HK), as conventional hospital acquisitions typically involve only small sized hospitals, with low number of patient beds and profitability.
- Renji remains our pick in China's healthcare space. Maintain our BUY call, target price HK$0.20, representing 22.0x FY12/09F P/E.

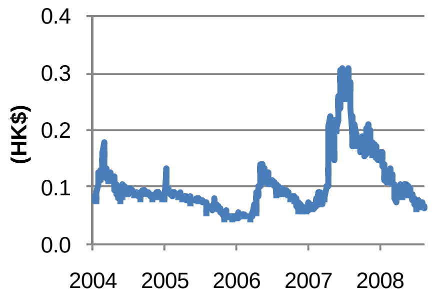
Stock data

Price	**HK$0.067**
Target price	HK$0.20 (+135%)
12 mth range	HK$0.074-0.335
Market cap.	US$95.1m
Daily t/o, 3 mth	US$0.41m
Free float %	70.5%
Ticker	0648.HK/648 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK$m)	9.1	58.5	189.1	273.0	312.6
Net profit (HK$m)	(83.0)	12.8	34.0	100.8	133.0
EPS (HK$)	(0.018)	0.002	0.003	0.009	0.012
EPS Δ %	19.3	N/A	87.3	196.8	31.9
P/E (x)	N/A	42.1	22.5	7.6	5.7
P/B (x)	3.52	0.61	0.72	0.66	0.59
EV/EBITDA (x)	40.8	45.8	5.2	3.1	2.1
Yield (%)	-	-	-	-	-
ROE (%)	N/A	1.7	2.9	9.1	10.9
ROCE (%)	N/A	N/A	6.0	11.2	13.3
N. Gear. (%)	Cash	2.8	0.8	Cash	Cash

Price Chart



Company background. China Renji (Renji) operates and manages a network of medical centres in China specialising in the treatment and diagnosis of cancer. The company has a focus in the use of PET-CTs and MRIs for diagnosis and use of gamma radiotherapy for treatment of cancer. Formerly "Softbank Investment Int'l (Strategic) Ltd.", the company entered into China's healthcare services industry through the acquisition of Anping Renji in Jul 2007. The consideration for the acquisition was HK$641.0m, consisting of HK$50.0m cash, HK$271.0m in new shares (at HK$0.10/share) and HK$320.0m promissory note.

What's new

- In Aug 2008, announced the acquisition of CD&T medical centres at Shenzhen Luohu People's Hospital (40.0%) and Shandong Ankang Hospital (51.0%) for a consideration of RMB14.3m and RMB15.0m, representing a P/B of 1.7x and 1.6x respectively.
- In Jul 2008, announced the 100.0% acquisition of Wuhan General Hospital Gamma Knife Treatment and Research Centre for RMB27.0m, representing 6.0x warranted revenue for the first and second years of operations after the completion of the acquisition.
- In Jun 2008, company announced the 100.0% acquisition of Shijiazhuang Hua Guang Tumour Hospital Holy Digital Radiation Therapy Centre, Hebei for RMB24.0m. The valuation is similar to the Wuhan acquisition, at 6.0x warranted revenue for the first and second years of operations after the completion of the acquisition.

- A second acquisition in Jun 2008. This time announced the 100.0% acquisition of the PET-CT inspection centre at Xijing Hospital, Xian Province for a consideration of RMB50.0m, representing a valuation of 2.0x P/B or 5.0x warranted revenue.
- Together with the acquisition of the remaining 49.0% of the CD&T medical centre at Er Pao, announced in Jan 2008, Renji has made a total of 6 acquisitions in 2008.

Investment theme

- Cancer is the no. 1 cause of death in China, with a mortality rate of 176.2/100,000 urban areas, and accounting for 28.5% of total deaths.
- At an estimated 10-12% of market share, Renji is one of the largest gamma radiotherapy service providers in terms of available gamma knife equipment. More importantly however, is the fact that its equipment is located in high disposable income areas such as Shanghai and Beijing. We estimate that Renji has around 50% and 30% of the available gamma knife equipment in these areas.
- Renji's medical centre network now spans Shanghai, Beijing, Nanchang, Hefei, Shenyang, Xian, Shijiazhuang, Wuhan, Jining and Shenzhen.
- Renji's partners are all Grade 3A hospitals, ensuring large catchment areas and large in-patient volumes and good complementary infrastructure (such as hospital beds, nurses etc).

Risks

- Regulatory risks relating to the healthcare industry.
- Ability to secure employees with necessary skills.
- Escalation in market competition for acquisition targets.
- Execution risk relating to the integration of newly acquired centres.

Table 1: P&L

Year to Dec (HK$m)	06A	07A	08F	09F	10F
Revenues	**9.1**	**58.5**	**189.1**	**273.0**	**312.6**
Cost of sales	(0.9)	(33.8)	(69.9)	(76.8)	(78.5)
Gross profit	**8.2**	**24.6**	**119.2**	**196.2**	**234.0**
Other revenues	5.9	5.0	5.6	6.1	6.7
Distribution expenses	-	-	-	-	-
Administrative expenses	(40.0)	(64.1)	(37.7)	(38.9)	(40.1)
Exceptionals	(16.3)	(13.5)	-	-	-
Finance costs	(3.9)	(26.6)	(16.8)	(14.6)	(12.2)
Share of results from associates	(54.6)	(0.7)	-	-	-
Profit before tax	**(100.8)**	**(75.4)**	**70.3**	**148.8**	**188.5**
Tax	-	(1.5)	(33.0)	(42.9)	(49.6)
Profit from continuing operations	**(100.8)**	**(77.0)**	**37.4**	**105.9**	**138.8**
Profit from discontinued operations	17.3	93.7	-	-	-
Profit for the year	(83.4)	16.8	37.4	105.9	138.8
Minority interest	0.4	(4.0)	(3.4)	(5.0)	(5.8)
Net profit	**(83.0)**	**12.8**	**34.0**	**100.8**	**133.0**

Source: Company data, SBI E2-Capital

Town Health Int'l

Devil is in the details

Not Rated

China Healthcare

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Our View

- We think that company has commanding market share in Hong Kong and that it would be prime beneficiary of HKSAR government's healthcare reforms. However, we expect upward pressure on labour costs and rent may pressure margins.
- There is not much detail (in terms of business model, operating metrics, structure) for its China chain clinic JV. We however, note that the clinic business is traditionally a marginally profitable business at best. We expect that Town Health will initially acquire loss making family run clinics.
- We are unclear as to the necessary scale to make its China business profitable. Until more detail emerges, we prefer to sit on the sidelines.

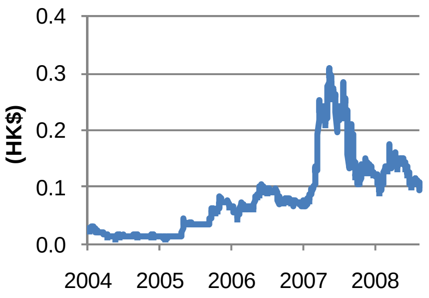
Stock data

Price	**HK$0.108**
Target price	N/A
12 mth range	HK$0.09-0.243
Market cap.	US$238.5m
Daily t/o, 3 mth	US$1.6m
Free float %	54.1%
Ticker	3886.HK/3886 HK

Financial summary

Year to Mar	05A	06A	07A	08F	09F
Turnover (HK$m)	231.2	236.6	338.8	-	-
Net profit (HK$m)	20.0	214.9	253.7	-	-
EPS (HK$)	0.002	0.014	0.015	-	-
EPS Δ %	N/A	827.7	10.8	-	-
P/E (x)	72.0	7.8	7.0	-	-
P/B (x)	5.4	3.6	1.8	-	-
EV/EBITDA (x)	39.2	237.4	67.5	-	-
Yield (%)	N/A	N/A	1.0	-	-
ROE (%)	10.8	62.7	33.8	-	-
ROCE (%)	18.0	76.8	78.8	-	-
N. Gear. (%)	Cash	Cash	Cash	-	-

Price Chart



Company background. Town Health International (Town Health) operates the largest privately-owned clinic chain in Hong Kong, with over 100 clinics, with 800+ full time staff and 145+ doctors and dentists. The company has over 900,000 patient records.

What's new

- In Apr. 2008, company announced that it has entered into a framework agreement with Ping An Insurance Group to develop and manage chain clinics in the Guangdong Province. Through a trust vehicle, Ping An and Town Health will contribute, on a 50:50 basis, to set up a 80/20 JV with a company wholly-owned by Sun Yat-sen University. The initial funding into the JV will be RMB300.0m.
- The JV aims to set up the chain clinic initially through acquisitions and then building out by organically establishing new clinics. Town Health plans to mesh its operational expertise with the brand name and network of Ping An to become the first chain clinic in China.
- At the same time, Town Health granted a call option to Ping An for the right to subscribe for up to 3,393,583,143 shares in the company, representing 19.99% of the existing share capital. The call option has an exercise price of HK$0.12/option share and is exercisable within 12 months from when the Call Option Agreement becomes unconditional.
- Company has successfully applied to transfer to the Main Board of the HKEx. From 11 Aug. 2008, company will trade under the ticker of "3886 HK".
- Company's turnover grew 43.2% YoY to HK$338.8m in FY3/08A. Gross profit increased 42.9% to HK$167.3m, while net profit was up only 18.1% to HK$253.7m after the incorporate of one-off items. The strong top line growth was boosted by an acquisition in FY3/07A. Excluding one-off items, core operating profit surged 126.0% YoY to HK$50.4m. On an organic basis, excluding the acquisition, revenues improved 19.2% YoY to HK$275.6m.

Investment theme

- Public healthcare spending in Hong Kong was HK$38.0b in 2007, accounting for around 55% of the healthcare market. The government has plans to reform the sector after projecting that government spend will escalate to HK$80.0b in 15 years. The reforms are aimed at keeping public healthcare spending to below 17% of total government budget.
- Town Health, being the largest clinic operator in Hong Kong, will be a key beneficiary as the reforms are generally aimed at encouraging patients to use private sector facilities. These reforms include measures such as: 1) subsidised elderly with HK$250 healthcare coupons per year; 2) increasing public sector healthcare charges and 3) implementing schemes to transfer patients from public specialist clinics to private doctors.
- In China, the central government is committed to spending over RMB190.0b on healthcare reform this year, with a large portion earmarked for improving healthcare facilities in primary, community and rural areas. The reforms also includes the gradual opening up of the sector to foreign investment. This will figure to speed up the development and improve efficiency of China's healthcare system. It is estimated that Guangdong Province itself can support ~25,000 clinics.
- At present, there are no chain clinics in China. Town Health plans to leverage Ping An to become a first mover in this area. For Ping An, owning a stake in a chain clinic will increase vertical integration of its health insurance supply chain.

Risks

- Failure to find suitable acquisition targets to build out its chain clinic operations in China.
- Emergence of rival chain clinic operator in China with significant financial resources.
- Government regulations, which negatively affects foreign investment in China's healthcare sector.

Table 1: P&L

Year to Mar (HK$m)	06A	07A	08A	09F	10F
Turnover	**231.2**	**236.6**	**338.8**	**-**	**-**
Cost of sales	(119.3)	(119.5)	(171.5)	-	-
Gross profit	**111.8**	**117.1**	**167.3**	**-**	**-**
Other income	9.8	64.8	44.3	-	-
Administrative expenses	(91.0)	(99.6)	(129.1)	-	-
Other expenses	(3.9)	(7.8)	(13.3)	-	-
Finance costs	(2.4)	(3.5)	(5.3)	-	-
Exceptionals	-	1.9	33.9	-	-
Share of results of associates	(0.5)	2.7	8.0	-	-
Share of results of JCEs	-	-	235.6	-	-
Gains/losses from CBs	-	165.4	(73.5)	-	-
Increase in fair value of properties	3.8	2.3	4.1	-	-
Profit before tax	**27.7**	**243.4**	**272.0**	**-**	**-**
Tax	(6.3)	(14.4)	(11.8)	-	-
Profit from continuing operations	**21.4**	**228.9**	**260.2**	**-**	**-**
Discontinued operations	-	(22.1)	(0.8)	-	-
Minority interest	(1.4)	8.1	(7.3)	-	-
Net profit	**20.0**	**214.9**	**253.7**	**-**	**-**

Source: Company data

Hua Xia Healthcare

Focus on small scale hospitals

Not Rated

China Healthcare

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Our View

- Though Hua Xia has an aggressive expansion strategy and niche focus of female healthcare services, we believe that the business model may be difficult to scale up given that the acquired hospitals are small (<200 beds).
- We think that there is significant competition in China amongst hospitals of this size. Moreover, there would be many foreign and domestic private investors seeking to claim a stake of China's lucrative healthcare industry by acquiring such hospitals. This may drive up acquisition valuations in future.
- Competition may ultimately limit Hua Xia's ability to develop a sizeable network of hospitals in China.

Company background. Hua Xia Healthcare (Hua Xia) is focused on hospital management services and healthcare investment in the PRC. The company entered into the healthcare business in China via the acquisition of Day View Group Ltd., announced in Jun. 2006. The company changed its name to Hua Xia Healthcare (from previously Grandy Corporation) in Aug. 2006 and the acquisition was completed Nov. 2006.

What's new

- Acquired 100.0% of Bengbu City Aomeijia Female Hospital (New Aomeijia Hospital) in Jul. 2008 for a cash consideration of HK$49.0m.
- New Aomeijia Hospital is a privately run hospital located in Bengbu City, Anhui. It is one of China's first hospitals to focus on female healthcare and gynecology. The vendor has warranted that the net profit for the facility shall not be less than HK$5.0m for the year ending 31 Dec. 2009, implying an acquisition consideration of 9.8x P/E.
- Hua Xia's FY3/08A revenue was up 238.8% YoY to HK$114.2m (99.4% of revenues from hospital-related activities). The surge in revenue was mainly due to maiden contribution from its Chongqing St. Edward Hospital and JiaxingShuguang Hospital. However, due to one-off items from goodwill impairment (HK$30.3m) and loss on disposal of subsidiaries (HK$14.6m), the company recorded a loss from continuing operations amounting to HK$10.9m. Excluding these items, Hua Xia would have recorded a profit of HK$34.0m.

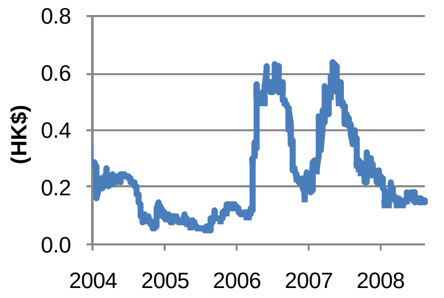
Stock data

Price	**HK$0.146**
Target price	N/A
12 mth range	HK$0.130-0.445
Market cap.	US$35.4m
Daily t/o, 3 mth	US$0.03m
Free float %	57.6%
Ticker	8143.HK/8143 HK

Financial summary

Year to Mar.	06A	07A	08A	09F	10F
Turnover (HK$m)	41.1	77.5	114.2	-	-
Net profit (HK$m)	3.2	5.9	(17.8)	-	-
EPS (HK$)	0.006	0.009	(0.011)	-	-
EPS	N/A	69.1	N/A	-	-
P/E (x)	26.5	15.7	N/A	-	-
P/B (x)	2.09	1.2	0.5	-	-
EV/EBITDA (x)	41.7	42.4	6.9	-	-
Yield (%)	N/A	N/A	N/A	-	-
ROE (%)	7.3	5.2	N/A	-	-
ROCE (%)	10.6	11.3	N/A	-	-
N. Gear. (%)	26.4	Cash	Cash	-	-

Price Chart



- In FY3/09, Hua Xia has acquired two hospitals, Shangrao Consonancy Hospital and New Aomeijia Hospital. Management is targeting another 2 more hospitals before the end of the current financial year.

Investment theme

- Huaxia is taking advantage of the Chinese government's gradual opening up of China's healthcare sector.
- Growth strategy is two-pronged. Continuous expansion of hospital network through acquisitions, and improvement of the operating efficiency of each hospital under management to increase profitability.

- The company currently owns 5 hospitals, including: 1) 55.0% of Chongqing St. Edward Hospital; 2) 55.0% of Jiaxing Shuguang Hospital; 3) 70.0% of Foshan Qide Hospital; 4) 70.0% of Shangrao Consonancy Hospital and 5) 100.0% of New Aomeijia Hospital. Typical valuation for an acquisition is around 10.0x P/E.
- Track record suggest that Huaxia's investment targets are small sized hospitals (<200 beds) with a more of a focus on provision of healthcare services for females. Chongqing St. Edward Hospital is particularly strong in the areas of obstetrics and gynaecology, while Jiaxing Shuguang Hospital is renowned for its cosmetics ward.

Risks

- Shortage of human resources to accommodate company's aggressive expansion strategy.
- Larger, better funded public and private hospitals vertically integrating services offered by those currently owned by Hua Xia
- Government regulation risk.

Table 1: P&L

Year to Mar (HK$m)	06A	07A	08A	09F	10F
Turnover	**41.1**	**77.5**	**114.2**	**-**	**-**
Cost of sales	(19.3)	(35.8)	(39.6)	-	-
Gross profit	**21.8**	**41.7**	**74.6**	**-**	**-**
Other revenue	0	0.6	3.4	-	-
Other Income	3.5	-	6.9	-	-
Selling and distribution costs	(2.0)	(1.2)	(5.7)	-	-
Administrative expenses	(18.4)	(30.1)	(35.6)	-	-
Impairment loss on goodwill	-	(1.9)	(30.3)	-	-
Loss on disposal of subsidiaries	-	-	(14.6)	-	-
Provision for impairment on trade and other receivables	(1.0)	(0.1)	-	-	-
(Loss)/Profit from operation	**4.0**	**9.0**	**(1.3)**	**-**	**-**
Finance costs	(0.3)	(1.0)	(3.4)	-	-
Pre-tax profit	**3.7**	**8.1**	**(4.8)**	**-**	**-**
Tax	(0.6)	(1.2)	(6.2)	-	-
Profit from continuing operations	**3.1**	**6.9**	**(10.9)**	**-**	**-**
Profit from discontinued operations	-	-	3.2	-	-
Minority Interest	0.1	(0.9)	(10.1)	-	-
Net profit	**3.2**	**5.9**	**(17.8)**	**-**	**-**

Source: Company data

Appendix I: Valuation Table

Valuation Table

Company name	Ticker	Country	Mkt Cap (US$m)	Price (HK$)	Cur Yr P/E (x)	Nxt Yr P/E (x)	P/B (x)	ROE (%)	Yield (%)
China Pharmaceuticals									
Guangzhou Pharmaceuticals	874 HK	China	989.1	HK$4.79	11.0	9.2	1.11	10.6	2.9
China Pharmaceuticals	1093 HK	China	533.7	HK$2.78	8.2	7.9	1.60	0.6	-
Sino-Biopharmaceuticals	1177 HK	China	405.7	HK$1.44	9.7	8.6	1.45	11.4	4.6
Shineway	2877 HK	China	591.7	HK$5.60	10.0	8.4	2.20	22.2	4.2
United Laboratories	3933 HK	China	508.6	HK$3.72	6.5	5.6	1.80	27.1	
Shandong Luoxin	8058 HK	China	280.9	HK$3.54	12.2	9.1	6.70	45.8	2.9
Tong Ren Tang Tech	8069 HK	China	227.3	HK$9.32	9.7	8.5	1.40	13.4	0.5
C&O Pharmaceutical	COPT SP	China	123.2	S$0.26	8.0	6.3	3.10	15.7	-
China Nepstar	NPD US	China	893.9	US$8.45	20.3	14.2	0.40	7.3	-
Simcere Pharmaceutical	SCR US	China	766.9	US$12.10	13.5	11.0	6.40	24.8	-
China Medical Devices									
Mingyuan Medical	233 HK	China	360.0	HK$0.98	16.1	12.0	3.40	18.0	1.8
Golden Meditech	8180 HK	China	468.4	HK$2.38	10.5	9.6	1.10	23.6	-
Shandong Weigao	8199 HK	China	1,440.0	HK$11.40	25.6	19.6	7.70	30.4	0.6
Mindray Medical	MR US	China	4,019.3	US$44.04	32.3	21.8	12.60	24.1	0.4
China Healthcare									
China Renji	648 HK	China	95.1	HK$0.067	7.6	5.7	0.72	2.9	-
Town Health Int'l	3886 HK	China	238.5	HK$0.108	-	-	1.80	33.8	1.0
Hua Xia Healthcare	8143 HK	China	35.4	HK$0.146	-	-	0.50	-	-

Source: Bloomberg Estimates, SBI E2-Capital

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