China healthcare/pharmaceuticals

Hong Kong/ China & Singapore

Small/ Mid Cap Research

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Vital signs for growth

The deregulation of China's healthcare industry and policies to encourage investment in medical infrastructure and management are high on the agenda of the 17th National Congress of the Communist Party of China, which started on 15 October 2007. The focus comes after the 11th Five-year Plan(2006-2010) stressed the need to: 1) improve medical and health services; 2) modernise China's pharmaceutical production industry; 3) speed up rural economic development and 4) improve public services in urban and rural areas. This paves the way for China's healthcare and pharmaceutical sectors to enter a period of fast sustainable growth. The restructuring of the pharmaceutical industry has created a better operating environment for quality pharmaceutical companies. China's urbanization, emerging middle class, improving medical coverage in urban and rural areas, and increasing popularity of insurance are fuelling demand for healthcare services and pharmaceutical products. In our profile, we have selected small-to-mid cap healthcare/pharmaceutical companies with:

- niche focus - provision of healthcare services directly or indirectly benefiting from the growing demand for healthcheck services and healthcare insurance;
- strong and scalable operating networks of healthcare services;
- R&D capabilities and new drugs already launched or with product permits are ready to be launched onto the market;
- solid brand name or product awareness; and
- broad distribution networks for own or third party products.

Profiled companies

Company	Ticker	Recomm.	Share price*	Target price	*Upside (%)*
China Renji	648 HK	BUY	HK$0.16	HK$0.45	*181.3*
Sino Biopharmaceuticals	1177 HK	BUY	HK$1.45	HK$2.27	*56.6*
C&O Pharmaceutical	COPT SP	HOLD	S$0.56	S$0.60	*7.1*
Mingyuan	233 HK	Not Rated	HK$1.27	N/A	N/A
Guangzhou Pharmaceutical	874 HK	Not Rated	HK$8.78	N/A	N/A
Shandong Luoxin	8058 HK	Not Rated	HK$4.78	N/A	N/A

** All prices are as of market close of 15 Oct, 2007*

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Vital Signs for growth

Healthcare reforms - the focus of 17th CPC National Congress

China's healthcare and pharmaceutical industry reforms are expected to take a front row seat during the 17th CPC National Congress, which started on 15 October 2007. The focus comes after the 11th Five-year Plan identified the need to: 1) improve medical and health services; 2) modernize China's medical production industry; 3) speed up rural economic development and 4) improve public services in urban/rural areas. We expect the government to announce new initiatives and policies to deregulate the sector and encourage investment to stimulate growth.

Healthcare objectives in 11th Five-year Plan

The healthcare system reform is a key initiative in the 11th Five-year Plan, focusing on: 1) basic medical services; 2) grass root health development; 3) response system for public health emergencies and 4) public health system. Table 1 shows the details of the initiatives.

Table 1: Healthcare objectives under 11th Five-year Plan

Area	Policies
Medical and health services	❑ deepen reforms to create a dual-dimensional system covering community health service agencies and large and mid-sized regional hospitals; ❑ improve the basic medical service capacity of communities; ❑ gradually address "difficult and expensive medical treatment" issues; ❑ develop general medical centers in new towns and suburbs; ❑ further open the medical service market; ❑ encourage and guide social capital in building medical service agencies; ❑ tighten control over drug and medical service prices; curb increases in medical charges.
Grass root health development	❑ coordinate the planning of urban and rural community health service networks; ❑ categorize and standardize health service centers (stations); strengthen their public health service functions; ❑ realize "in-community treatment of small illnesses and timely referral in case of serious diseases"; ❑ extend rural health infrastructure and training for medical service backbones; ❑ meet the demands of rural residents for basic medical health services in terms of infrastructure, doctor and nurse numbers, service capability; improve medical assistance systems for the poor.
Response system for public health events	❑ improve Beijing's response system for public health emergencies; ❑ build a regional coordination mechanism; ❑ create a municipal and district or county two-tier centre for emergency command under the principle of local management and unified command; ❑ improve an emergency decision-making command system; ❑ enhance quick response capacity and cure capacity for emergencies ❑ ensure life and health safety of urban and rural residents.
Public health system	❑ build a unified and effective system for disease prevention and control; ❑ intensify prevention and control of major contagious diseases; ❑ improve the medical assistance system consisting of emergency rescue, contagious disease treatment, occupational poisoning and nuclear radiation treatment; ❑ consolidate public health information resources on epidemic and disease situations, detection and warning systems; ❑ create an integrated network for public health information; ❑ strengthen supervision of health law enforcement; ❑ tighten checks and market surveillance, improve the capacity of health supervision and law enforcement.

Source: Minister of Commerce

Lack of affordable healthcare for urban and rural residents

The reform of state-owned enterprises (SOEs) in the 1990s had a major impact on China's healthcare system. In the past, urban residents received free healthcare by virtue of their employment by SOEs. After restructuring or downsizing due to competition, SOEs faced difficulties in financing healthcare for employees. Some simply went out of business and their employees lost their healthcare coverage along with their jobs. A similar scenario occurred in rural areas. Agricultural reforms eliminated communes, which funded the "cooperative medical system" (CMS), the core healthcare program for rural residents at the time. As the CMS collapsed, provision of healthcare became the responsibility of local governments, which in most cases were poorly financed with no adequate healthcare infrastructure. In 1998, China introduced the Urban Employee Basic Medical Insurance System (UEMBIS), under which the employer contributes 6% and employee 2% of the employee wage. In 2003, the Rural Cooperative Medical Scheme was launched under which individuals and the government contributed RMB10 each annually to a locally managed cooperative fund. . Despite efforts to reform the healthcare system and make it affordable, 48.9% of people chose not to go to hospital for treatment due to economic reasons, according to the Ministry of Health.

Table 2: Basic medical plans (prior to 2006)

Medical plan	Area	Description
Urban Employee Basic Medical Insurance Scheme (UEBMIS)	Urban	The employer contributes 6% and employee 2% of the employee wage
Rural Cooperative Medical Scheme	Rural	Individual and government contribute RMB10 each annually to a locally managed cooperative fund

Source: SFDA, SBI E2-Capital

Healthcare spending growth below GDP growth

Although China has increased its public spending on healthcare over the last few years, the rate was slower than its GDP growth. This is further illustrated by the fact that personal out-of-pocket health expenditure (as a percentage of total healthcare expenditure) increased from 35.7% in 1990 to 52.2% in 2005, down from a high of 59.0% in 2000, but still significantly higher than in developed countries. Moreover, out-of-pocket medical expenses increased in absolute terms at a CAGR of 76% between 2000 and 2005. The government's healthcare expenditure fell from 25.1% of total healthcare expenditure in 1990 to 17.9% in 2005.

Table 3: Health expenditure

	1980	1990	1995	2000	2003	2004	2005
Total health expenditure (RMBb)	14.32	74.74	215.51	458.66	658.41	759.03	865.99
Government health expenditure (RMBb)	5.19	18.73	38.73	70.95	111.69	129.36	155.25
Social health expenditure (RMBb)	6.10	29.31	76.78	117.19	178.85	222.54	258.64
Personal health expenditure (RMBb)	3.03	26.70	100.00	270.52	367.87	407.14	452.10
Government health expenditure (%)	36.2	25.1	18.0	15.5	17.0	17.1	17.9
Social health expenditure (%)	42.6	39.2	35.6	25.5	27.2	29.3	29.9
Personal health expenditure (%)	21.2	35.7	46.4	59.0	55.8	53.6	52.2

Source: MOH

Table 4: Health expenditure as % of GDP

	1980	1990	1995	2000	2003	2004	2005
Total health expenditure (RMBb)	14.32	74.74	215.51	458.66	658.41	759.03	865.99
Government health expenditure (RMBb)	5.19	18.73	38.73	70.95	111.69	129.36	155.25
Total health expenditure in GDP (%)	3.17	4.03	3.54	4.62	4.85	4.75	4.73
Government health expenditure in GDP (%)	1.15	1.01	0.64	0.72	0.82	0.81	0.85

Source: MOH

RMB31.3b to be invested to reform the system

The Chinese government aims to address the core issue that it is difficult and expensive to see a doctor and fulfill its promise to WHO to make medical insurance coverage available to all residents by 2010. In 2007, the central government earmarked RMB31.3b for healthcare, up 86.8% from 2006. Some of its initiatives are shown in Table 5.

Table 5: Healthcare reform initiatives

Area	Policies
Urban	❑ trials of a basic medical insurance system for urban residents in 2007; expand the cover to urban residents without regular employment and to the whole country by end- 2010 ❑ improve subsidized medical care for urban residents by increasing budgetary allocations, conducting subsidized medical care trials ❑ set up a system to ensure funding for healthcare services in urban communities ❑ standardize and institutionalize the urban healthcare system
Rural	❑ expand the trial of the new rural medical cooperative system to more than 80% of the country's rural areas by end-2007 and 100% by end-2010 ❑ increase capacity of healthcare services at the community and village level.
Others	❑ promote free prevention and treatment of major communicable diseases ❑ replace central government with local governments as the main source of funding for the prevention and treatment of major communicable diseases ❑ revitalize and promote the development of traditional Chinese medicine

Source: NDRC

Shift in government funding to individuals creates opportunities for the private sector

The new initiatives represent a fundamental shift in government healthcare funding from hospitals to individuals. Meanwhile, hospitals are under intense pressure from the government and patients to improve their efficiency and quality. We believe this will open up opportunities for the private sector to invest in healthcare service providers and boost private participation in the ownership structure and operating models. To encourage medical infrastructure investment, the Chinese government has allowed up to 70% foreign ownership in medical institutions. Going forward, we expect it to play a central role in improving the quality of healthcare institutions in China through policy setting and gradual introduction of competition in the hospital system.

Table 6: Issues facing hospitals in China

Tier	Issues	Opportunity for private participation
Tertiary (Largest)	Improve quality of care and efficiency Become regional "centres of excellence" to maintain leading status	Capital funding to: 1) facilitate expansion through M&A; 2) expand treatment portfolio and 3) attract better quality doctors Management input to improve operating efficiency and patient care quality
Secondary (Mostly regional)	Develop medical infrastructure Improve management skills	Facilitate JVs to enlarge patient base Management input to improve operating efficiency and patient care quality
Primary (Small community health centres)	Increase number of patients to generate sufficient revenue	Management input to improve cost control, operating efficiency and patient care quality
Special service hospitals	Develop brand name, reputation and specialized services	Capital funding in leading technologies

Source: SBI E2-Capital

Government lowers drug costs to boost affordability

In a bid to improve healthcare affordability by lowering medicinal cost, the State Food and Drug Administration (SFDA) and National Development and Reform Commission (NDRC) implemented a series of measures over last three years, including:

- reducing price caps on medicines
- imposing stricter drug registration procedures
- reviewing previously approved drug applications
- tightening governance of pharmaceutical distributors
- implementing a centralized drug procurement system for hospitals to prevent "kickbacks" to doctors

- clamping down on corruption to tighten drug approvals and reduce over prescription of medicines in hospitals

The last two measures have had a particularly large impact on the industry as it is generally acknowledged that kickbacks and over prescriptions played a significant role in inflating retail prices and medical costs. The clamp down culminated in the prosecution and execution of the former SFDA head, Zheng Xiaoyu, in July 2007.

Magnitude of price adjustment decreasing

The NDRC has implemented 24 rounds of medicine price cuts since 1997. After peaking in August 2006 with an average reduction of 40%, the magnitude has decreased to 15-20% with the focus on western medicines. In our view, most cuts have already been made for western/generic medicines and any subsequent price adjustments will be moderate.

Table 7: Drug price cuts

Year	Number of cuts	Average price cut
1997	1	Oct (-15%)
1998	1	Apr (-10%)
1999	3	Apr (-20%), Jun (-5%), Aug (-15%)
2000	3	Jan (-10%), Jun (-15%), Oct (-20%)
2001	3	Apr (-20%), Jul (-15%), Dec (-20%)
2002	2	Jul (-10%), Dec (-15%)
2003	2	Jan (-10%), Sep (-14%)
2004	1	May (-30%)
2005	1	Sep (-35%)
2006	3	Jun (-23%), Aug (-40%), Nov (-15%)
2007	4	Jan (-20%), Feb (-15%), Apr (-16%), May (-19%)

Source: NDRC

Restructuring weeds out low quality players

The initiatives reduced the turnover growth of the China's pharmaceutical industry from around 26.3% in 2005 to 16.3% in 2006 and net profit growth to 10.1% from 19.0% in 2005. The actual impact of NDRC price cuts was lower than the magnitude of downward adjustments. This is because competition in the industry and the tendering systems at hospitals meant that many of western/generic medicines were already sold at prices below government-set price caps. While the adjustments will lead to some downward pressure on drug prices, the main impact of the price adjustments was the narrowing of gap between manufacturer's selling price and government price cap. The slower deceleration of revenue suggests that the lowering of prices may have stimulated volume demand for drug medicines. The faster deceleration of net profits was a result of increased selling and marketing expenses as companies stepped up their product promotions and had to educate doctors in the benefits/features of their products in the absence of "kickbacks" and the old abnormally tiered distribution system. Thus, the main impact of the government's restructuring was a one-off correction in the operating cost structure of pharmaceutical companies. Large quality players were able to absorb this and sustain sales of their products, while small and poor quality companies were pushed out of the market as sales plummeted and operating costs skyrocketed.

Industry rebound in 2007

By 2007, the impact of most of the measures has largely been absorbed and the industry begun to recover, with turnover up 21.8% YoY at RMB267.8b and net profit up 34.1% YoY at RMB23.1b for 1H FY12/07A. This macro trend was mirrored at the micro level. With the recovery, increasing exports of Active Pharmaceutical Ingredients (APIs) and generic drugs to western countries and China's gradual emergence as a destination for contract research outsourcing (CRO), we believe the industry is at the threshold of a period of sustainable growth.

New drug approvals to recommence, but under stricter regulations

According to our channel checks, the SFDA slowed down its new product approvals during restructuring, with many pharmaceutical companies failing to receive any approvals since 2H 2006 due to 1) formulation of new registration and approval procedures; 2) nationwide review of all new drug approvals already issued and 3) SFDA's wait for the impact of restructuring initiatives to take shape. Finally, on 11

July 2007, one day after the execution of Zheng, the administration released a newly revised Statute on Drug Registration and Management, which set out stricter procedures for drug registration and approval. A major change was the narrowing of the definition of "new drugs". Previously, generics with different dosages, use adjustment or improvements in production techniques could be categorized as new drugs. The amended statute stipulated that only those appearing in the Chinese market for the first time can be defined as new drugs. Therefore, while we expect the approval process to recommence after the 17th CPC National Congress, the stricter regulations mean fewer new drug permits than in the past. We believe this will favour pharmaceutical companies with:

- strong R&D capabilities;
- new drugs that have already been launched or obtained product permits for drugs about to be launched onto the market; and
- strong distribution networks (as more emphasis will be placed on the distribution of existing drugs to drive growth).

Increasing variety of insurance products to spur demand for healthcare services

At the same time, the government has begun to encourage the use of private insurance plans. On the supply side, insurance companies have traditionally focused on accident/injury insurance products as over-prescription by doctors meant that healthcare insurance products were generally less profitable. However, with the government's recent efforts to stamp out these practices, the profitability of personal healthcare insurance products will increase, making them more attractive for insurance companies. According to the China Insurance Regulatory Commission, the nation's personal healthcare insurance premiums grew at a CAGR of 15.9% in 2003-2006. The Chinese are naturally health conscious and with the emerging middle class and rising disposable incomes, we expect healthcare products to become increasingly popular. Many insurance companies have already recognized this demand and are developing innovative new products and distribution channels. China Life (2628 HK) has teamed up with Mingyuan (233 HK) to launch a cancer specific healthcare insurance product. Other insurance companies plan to begin distribution of healthcare insurance products over the TV platform through infomercials. We expect that the proliferation of healthcare insurance will further spur demand for healthcare services in China.

Conclusion

China's healthcare and pharmaceutical sector is poised to enter a period of sustainable growth. The continuing deregulation, major investment projects by the central government and the post-restructuring recovery of the pharmaceutical industry mean a better operating environment and foreign investment opportunities. The country's urbanization, emerging middle class, improving medical coverage in urban and rural areas and proliferation of healthcare insurance policies will boost demand for healthcare services and pharmaceutical products. In our profile of small-to-mid cap healthcare/pharmaceutical companies, we have selected companies with the following attributes:

- niche focus - provision of healthcare services directly or indirectly benefiting from growing demand for healthcheck and healthcare insurances;
- strong and scalable operating networks of healthcare services;
- R&D capabilities and new drugs already launched or with product permits and to be launched onto the market;
- solid brand name or product awareness; and
- broad distribution networks.

Small-to-mid cap healthcare/pharmaceutical companies

China Renji (648 HK) – BUY

Unique focus in China's healthcare sector

Key investment themes are:

- Niche focus in the provision of healthcheck, cancer diagnosis and treatment services in China.
- High demand for services – Cancer is China's leading cause of death.
- Vertically integrated model of healthcheck, treatment and after-care services drives a strong patient lock-in business model. Cost structure and revenue sharing model with hospitals derives high margins.
- Since completion of Anping Medical to diversify into China's healthcare services sector, Renji has announced two acquisitions, in Beijing and Hefei, demonstrating strong acquisition ability.
- Reasonable acquisition valuations a sign that Renji's expanding network is bringing better bargaining power in M&A negotiations.
- Three-tiered expansion schedule comprising: 1) new equipment purchases; 2) new CD&T centres; 3) acquisitions of hospitals,
- Renji's hospital acquisition model of setting up a CD&T centre is far superior than straight up hospital acquisition as it can widen treatment services offered, increase patient catchment area and in-patient flow, and increase demand for regular hospital services.
- We have a BUY call on the counter with a target price of HK$0.45, representing 35.0x FY12/08F P/E, reflecting the strong long-term growth trend of China's healthcare sector.

Business focus

China Renji (Renji) operates and manages a network of medical centres focusing on the treatment of tumours/cancers. The company has specialty experience in the use of the head/body gamma knife, linear accelerators and PET-CT for diagnosis and treatment. Its revenue comes from three main business segments: 1) equipment leasing; 2) management/medical consultancy services and 3) hospital management fees.

Diversification into China's healthcare services sector through Anping Medical acquisition

The listed company diversified into the China healthcare services sector through the acquisition of Anping Medical. The HK$641.0m deal (comprising cash, shares and bonds) is subject to adjustments and represents 8.0x (9.2x) FY12/07F and 4.3x FY12/08F P/E based on net profit guarantees of HK$80.0m (HK$70.0m minimum) in FY12/07F and HK$150.0m. The acquisition was initially announced on 30 Apr 2007 and completed on 13 Jul 2007.

Revenue model derives high margins

Under its profit sharing model with hospitals, Renji is entitled to 25% as equipment leasing fees and around 20% as management/medical consultancy fees (depending on the mode of treatment) of the net treatment fees from each cancer in-patient received by the hospital. This cost structure allows Renji to command very high margins. Based on accounts in the acquisition announcement circular, Renji's FY12/06A net margin was 55.3%.

Advanced technology targeting high demand group

Gamma knife treatment can maximize patient comfort and is relatively fast at 15-30 mins per course. Head gamma treatment consists of two courses and body gamma treatment six to eight courses. According to China's Health Statistical Yearbook of 2006, cancer was the top cause of death in the country with a rate of 126.4 per 100,000 people and accounted for 24% of deaths in 2004. Meanwhile, medical healthcare expenditure per capita was RMB582.2 in 2004 and RMB600.9 in 2005, up 13.8% YoY. During the same period, medical health expenditure per capita as a percentage of overall expenditure per capita increased from 7.4% to 7.6%. This situation is likely to be further exacerbated by China's rapidly aging population. Reports have suggested that people aged over 65 are expected to represent around 8.2% of the total population by 2010. With an aging population, the incidence of potentially terminal illnesses, such as cancer, is expected to increase substantially.

Table 8: Gamma knife advantages

Advantages
Treats cancerous tumours at an earlier stage, leading to higher chance of success
No incision, no scars, no risk of haemorrhage or infection
Treatment is painless and in most casts, requires no general anaesthetics
Fast treatment time, high patient turnaround
High accuracy, target rays reach only the tumor, not surrounding healthy tissue
Can be used for inoperable tumours, vascular malformations, treatment of facial pain, focal epilepsy and Parkinson's disease

Source: Company data,SBI E2-Capital

Expansion opportunities abound

There are plenty of expansion opportunities for Renji as cancer treatment equipment outside of key Chinese cities such as Shanghai and Shenzhen appears to be undersupplied. For example, there are only three sets of body gamma knives and four sets of head gamma knives in Beijing at the moment, given that Shanghai has around 12sets.

Health check centre will increase lock-in effect

Renji typically includes healthcheck facilities, such as Pet-CT and MRIs in their CD&T centres. In our view, the healthcheck services is a low-risk, high-margin process which provides: 1) recurring income for Renji, which is expected to grow every year; 2) front-end services which can double up to act as a screening operation and funnel additional cancer patients into Renji's tumour/cancer medical centers. The vertically integrated business model commencing with healthcheck services upstream, medical diagnosis, consultancy and treatment services allows Renji to tie-in both patients and hospitals and integrate its cancer diagnosis and treatment services into the hospitals' operation process.

Strong execution ability since completion of Anping acquisition

To date, Renji has demonstrated strong execution ability. Its acquisition Anping was completed on 13 July 2007, ahead of the initial schedule. Since then, Renji has announced two acquisitions, in Beijing and Hefei at reasonable valuations. The lower valuation of the second acquisition is a sign that Renji's expanding network is bringing better bargaining power in M&A negotiations. It has up to five acquisition targets by end-FY12/07, with potential candidates in Shenyang, Xian, Hefei, Wuhan, Foshan and Jiangxi.

Table 9: Acquisition summary(since completion of Anping acquisition)

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

Source: Company data, SBI E2-Capital

Building a nationwide operating network

With these acquisitions, Renji broadens its medical network into a nationwide platform in China. With its operating base in Shanghai (3 centres), the company's Er Pao CD&T centre covers Huabei (northern) region, while Hefei CD&T centre covers Huadong (eastern) region. Meanwhile, minority stake in a CD&T centre in Nanchang gives the company access to Huazhong (central) region.

Anping unaudited 1H FY12/07 net profit on track to meet profit guarantee

Anping Medical (Anping) recorded unaudited turnover of RMB46.7m in 1H FY12/07A and net profit of RMB35.6m. Note that this was not consolidated into the listco accounts as the acquisition was only completed on 13 Jul 2007. We expect stronger 2H results because of long Chinese New Year and Labour Day holidays in the first half of the year and the fact that many Chinese tend to undergo major operations/treatments in the autumn period. We estimate the Shanghai 455 centre's full year FY12/07F revenue at RMB49.5m and Shanghai 411 CD&T centre's at RMB27.0m, putting the company well on track to attain its FY12/07 profit guarantee of HK$80.0m, notwithstanding any accretive boost from acquisitions.

Three-tiered expansion plan

The company has a three-tiered expansion schedule comprising: 1) new equipment purchases; 2) new CD&T centres; 3) acquisitions of hospitals, where it looks to acquire around 70%. Renji's typically seeks out top hospitals in second tier cities, with criteria of; 1) 200+ hospital beds and around 400-500 out-patient daily out-patient flows; 2) already deriving a profit and 3) return period of 2.0-2.5 years. Renji deploys an innovative investment method. Rather than a straight up cash consideration, the company invests the agreed acquisition consideration in a CD&T centre in return for a stake in the hospital. Including Jiangxi and Zhenzhou, Renji aims to set up seven new CD&T centres in FY12/07 and four in FY12/08. We estimate that Renji's capex requirements will be about RMB240.0m in FY12/07 and RMB315.0 in FY12/08.

Cancer diagnosis and treatment model far superior than hospital acquisition

We believe Renji's acquisition/investment model is far superior and potentially more profitable. In a straight up acquisition, the new management's strategy is typically limited to increasing the number of hospital beds and implementing management restructuring to improve profitability. However, it is important to note that increasing the number of beds may not lead to a substantial increase in in-patient flow. Renji's acquisition model of investing an agreed acquisition sum into a CD&T centre is able significantly increase the hospital's top line by: 1) improving its comparative advantage by offering treatment services not available in other nearby hospitals; 2) increasing its patient catchment area and in-patient flow and 3) increased demand for regular hospital services.

Valuation

We estimate Anping's net profit at RMB85.7m in FY12/07F and RMB156.3m in FY12/08F. Our net profit forecast for listco is a net loss of HK$6.6m for FY12/07F, followed by a net profit HK$157.3m for FY12/08F. We have a BUY call on the counter with a target price of HK$0.45, representing 35x FY12/08F P/E, reflecting the strong long-term growth trend of China's healthcare sector.

Table 10: P&L

Year to Dec (HK$m)	05A	06A	07F	08F	09F
Turnover					
Investment holding	2.5	6.4	9.0	-	-
Financial services	29.1	59.2	71.8	-	-
Media, consulting, technology	20.1	2.8	0.1	-	-
Garment manufacturing	53.7	64.2	67.4	-	-
Property holding & others	7.1	7.9	8.3	-	-
Medical services	-	-	85.5	332.8	389.6
	112.4	**140.2**	**242.2**	**332.8**	**389.6**
Cost of sales	(62.9)	(74.8)	(102.7)	(133.1)	(153.4)
Gross profit	**49.8**	**65.5**	**139.6**	**199.7**	**236.2**
Other revenues	2.6	15.2	21.2	22.6	69.8
Distribution costs	-	-	-	-	(0.1)
Administrative expenses	(73.4)	(84.3)	(115.3)	(27.8)	(54.8)
Other operating income/(expenses)	9.1	1.5	(9.6)	(12.5)	(25.1)
Exceptionals	(42.4)	(18.2)	(27.1)	1.9	1.0
Operating profit	(54.6)	(20.3)	8.8	183.9	227.0
Finance costs	(4.2)	(6.3)	(8.9)	(6.7)	(6.4)
Share of results from associates	(33.6)	(54.7)	(1.0)	-	-
Profit before taxation	**(92.4)**	**(81.3)**	**(1.1)**	**177.2**	**220.6**
Taxation	(0.8)	(2.1)	(4.2)	(17.2)	(21.6)
Profit after tax	**(93.2)**	**(83.4)**	**(5.4)**	**160.0**	**199.0**
Minority interests	(0.4)	0.4	(1.2)	(0.5)	(0.5)
Profit attributable to shareholders	**(93.6)**	**(83.0)**	**(6.6)**	**159.5**	**198.5**
% chg	*na*	*na*	*na*	*na*	*24.5*
Dividends	-	-	-	-	-

Source: Company data, SBI E2-Capital

Table 11: Financial Summary

Price	**HK$0.162**
Target price	HK$0.450
12 mth range	HK$0.057-0.335
Market cap.	US$235.3m
Daily t/o, 3 mth	US$2.0m
Free float %	86.3%
Ticker	0648.HK/ 648 HK

Year to 31 Dec	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	Gearing %
05A	(93.6)	(0.022)	na	na	9.8	na	na	na	na	Cash
06A	(83.0)	(0.018)	(19.3)	na	8.5	353.0	na	na	na	Cash
07F	(6.6)	(0.001)	(95.4)	na	2.8	37.4	na	0.3	5.0	Cash
08F	159.5	0.013	(1,687.3)	12.6	2.1	8.0	na	21.1	14.8	Cash
09F	198.5	0.016	24.5	10.1	1.7	6.4	na	20.8	15.5	Cash

Sino-Biopharmaceutical (1177 HK) – BUY

Value counter with strong pipeline of drugs already on the market

Key investment themes are:

- Strong incumbent pipeline of blockbuster drugs which are experiencing a re-acceleration of sales growth.
- Many of SB's potential blockbuster drugs are already on the market, which sidesteps the new drug registration procedures. Company now focused on driving their sales and turning the pipeline into sustainable revenue growth.
- Strong brand names for its cardio-cerebral, cancer and hepatitis drugs, which are experiencing strong demand growth.
- War chest of HK$1,759.7m net cash (HK$0.78 per share, representing 43.3% of the share price), ensures plenty of ammunition to conduct M&A activities.
- Trading at 7.9x ex-cash FY12/07F P/E, valuation is extremely attractive compared to peers. We have a BUY call and target price of HK$2.27, representing 23.0x FY12/08F P/E and 15.0x ex-cash FY12/08F P/E.

Business focus

Sino-Biopharmaceutical (SB) focuses on the manufacturing, distribution and research of proprietary chemical medicines and modern Chinese medicines in China. They include high-demand cardio-cerebral, hepatitis and oncology drugs.

Benefits from industry restructuring

The company's growth accelerated at the beginning of 2007 thanks to its new marketing strategy of refocusing on existing blockbuster drugs rather than just on new products and the recovery of China's pharmaceutical industry after a period of restructuring. In 1H FY12/07A, its net profit rose 49.8% YoY to HK$86.1m and turnover 52.3% to HK$503.8m. The net margin narrowed 0.3pcp to 17.1% due to a 117.2% increase in minority interests to HK$31.0m. The gross margin widened 1.4pcp to 80.8%.

Strong blockbuster drug sales

SB's principal and new blockbuster drugs benefited from the company's strong brand name and growing demand. In 1H, the sales of Kaishi injections rose 24.4% YoY to HK$195.0m and Ganlixin 4.7% YoY to HK$130.2m. The sales of Mingzheng Capsules, launched in July 2006, grew 158.7% to HK$75.8m.

Table 12: Interim revenue by business

	1HFY12/06			1HFY12/07				pct
	Revenue	% of Total	Margin	Revenue	% of Total	YoY	Margin	
Cardio-cerebral medicines	82.9	25.1	26.1	111.6	22.2	34.6	28.9	2.8
Hepatitis Medicines	195.3	59.0	15.9	304.3	60.4	55.8	23.1	7.2
Oncology Medicines	18.5	5.6	14.0	28.7	5.7	55.2	21.1	7.1
Others	28.3	8.6	0.4	54.1	10.7	91.0	(3.9)	(4.4)
Investment	5.7	1.7	-	5.1	1.0	-11.6	-	-
Total	330.8	100.0	-	503.8	100.0	52.3	-	-

Source: Company data

Targeting the right market

According to a June 2006 report by the NDRC, cancer was the leading cause of death in China, ahead of cardio-cerebral diseases. China had 120m hepatitis B carriers, 1/3 of the world's total.

Head start allows SB to sidestep new drug registration procedures

The company has been able to launch some potential blockbuster drugs ahead of the SFDA's move to introduce more stringent product approval procedures. It can now focus on driving their sales up and fuelling growth while many of its competitors are still trying to obtain approvals.

Table 13: Newly launched blockbuster products

Product	Therapeutic category	Launch date	Target to become blockbuster product
Tianqingganping enteric capsules	Hepatitis	May 2004	2007
Tianqingganmei injections	Hepatitis	Nov 2005	2008
Tianqingyitai injections	Oncology	Jan 2005	2008
Kaifen injections	Analgesic	Jan 2005	2009
Mingzheng capsules	Hepatitis	July 2006	2009
Tianqingning injections	Cardio-cerebral	Nov 2006	2010
Tianqingzhengs	Respiratory ailments	2006	2010

Source: Company data

Note: Blockbuster product-annual sales over RMB100 million

Cash per share represents 43% of current share price

The company currently has HK$1,759.7m in cash on hand (HK$0.78 per share - 43.3% of the share price). Its current annual capex stands at RMB20.0-30.0m suggesting plenty of ammunition for M&A activities.

Strong R&D capabilites

The company currently has 67 products with completed clinical tests, under clinical trials or undergoing approval procedures. In 1HFY6/07, it filed 10 patent applications and obtained 30 patents. Its R&D expenses are estimated at 5-8% of annual sales.

Investment in coal-to-olefin products

The company expects to invest RMB752.0m in refining coal into olefin in the FY12/08F-10F period. It formed a 43%-owned JV in Sep 2006 with tree other parties, including Shaanxi Coal Chemical, to do this project.

Valuation

We put SB's net profit at HK$193.2 for FY12/07F (17.0x P/E) and HK$224.0 for FY12/08F (14.7x P/E). We initiate coverage on SB with a target price of HK$2.27, representing 23.0x FY12/08F P/E and 15.0 ex-cash FY12/08F P/E.

Table 14: P&L

Year to Dec (HK$m)	05A	06A	07F	08F	09F
Turnover	756.1	734.7	1037.9	1319.9	1599.0
Cost of sales	(139.4)	(138.8)	(192.0)	(257.4)	(319.8)
Gross profit	616.7	595.9	845.9	1062.5	1279.2
Other income and gains	28.6	91.5.	103.8	105.6	111.9
Selling and distribution costs	(310.6)	(327.7)	(446.3)	(574.2)	(703.6)
Administrative expenses	(110.9)	(121.8)	(134.9)	(158.4)	(191.9)
Other operating expenses	(42.2)	(31.3)	(54.0)	(68.6)	(83.1)
Operating profit	181.6	206.6	314.5	366.9	412.5
Finance costs, net	(2.7)	(2.2)	(2.3)	(2.4)	(3.2)
Share of profits and losses of jointly controlled entities	-	-	-	-	-
Share of profits of an associated	-	0.7	1.0	1.3	1.6-
Exceptionals	(66.3)	-	-	-	-
Profit before taxation	112.5	205.1	313.3	365.9	410.9
Taxation	(18.3)	(22.1)	(47.0)	(54.9)	(61.6)
Profit from continuing operations	94.2	183.0	266.3	311.0	349.3
Profit from discontinued operations	1,558.4	-	-	-	-
Profit after tax	1,652.6	183.0	266.3	311.0	349.3
Minority interests	(119.7)	(41.8)	(73.1)	(87.0)	(99.6)
Profit attributable to shareholders	1,532.9	141.2	193.2	224.0	249.7
% chg	-	-	*36.8*	*15.9*	*11.5*
Dividends	(250.6)	(113.2)	(115.9)	(134.4)	(149.8

Source: Company data, SBI E2-Capital

Table 15: Financial Summary

Price	**HK$1.450**
Target price	HK$2.270
12 mth range	HK$0.9-2.2
Market cap.	US$420.9m
Daily t/o, 3 mth	US$0.5m
Free float %	25.0%
Ticker	1177.HK/1177 HK

Year to 31 Dec	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	Gearing %
05A	1532.9	0.713	-	2.0	1.8	12.1	7.6	82.7	8.1	Cash
06A	141.2	0.062	(91.3)	23.3	1.7	15.2	3.4	7.5	6.3	Cash
07F	193.2	0.085	36.9	17.0	1.6	7.4	3.5	9.8	11.0	Cash
08F	224.0	0.099	15.9	14.7	1.5	5.8	4.1	10.5	12.3	Cash
09F	249.7	0.110	11.5	13.1	1.4	4.6	4.6	10.91	13.1	Cash

C&O Pharmaceutical (COPT SP) – HOLD

Foreign partnerships to bear fruit

Key investment themes are:

- 4Q FY12/07A results solid as expected. Net profit up 29.9% QoQ at HK$40.8m.
- Focus on building out its distribution network and reach beginning to bear fruit. Sales force now at 800+, from 150 a year ago, with plans to expand to 1,200 by end of FY6/08F.
- Strategic alliance with Optimer comes hot on the heels of a distributorship agreement with Pharmco. With its sizeable distribution network and CMIA as strategic investor, C&O is becoming the preferred partner for mid-sized foreign pharmaceutical companies with China ambitions.
- Named exclusive distributor of Europharm's cough syrup for children would add more value.
- Further earnings upside from expanding into contract research outsourcing likely in FY6/09.
- We have a HOLD call on the counter, target price S$0.60, representing 15.0x FY6/08F P/E.

Business Focus

The company focuses on three main businesses: 1) marketing and sales of third-party pharmaceuticals in China, including foreign products; 2) manufacturing, marketing and sales of its own branded products; and 3) research, development and sales of technical know-how related to pharmaceutical products.

Solid results as expected

C&O's 4Q FY6/07A net profit came in at HK$40.8m, up 29.9% QoQ and down 11.8% YoY, while turnover increased 13.0% QoQ and 74.1% YoY to HK$207.4m. The gross margin was 44.7%, up 9.1 pcp QoQ and down 4.2 pcp YoY. The net margin was 19.7%, up 2.6 pcp QoQ and down 19.2 pcp YoY. Margins were eroded YoY due to the company's consolidation with Liancheng, which, as a distribution business, has a lower margin.

Expanding distribution ability

With the help of the Liancheng acquisition, the company has increased its sales force to 800+ from around 150 a year ago, allowing it to drive sales and sustain top line growth. We believe, the company, with its broad distribution network and re-accelerating growth, is poised to capitalize on SFDA's expected resumption of product approvals after the 17th Party Congress in October 2007. Gearing up for that, C&O aims to increase its sales force to around 1,200 by end-FY6/08A.

Partner of choice for overseas drug makers

C&O is becoming the partner of choice for mid-sized overseas pharmaceutical firms looking to break into China, thanks to its new strategic investor CMIA who introduced the company to foreign drug makers. Cooperation deals include: 1) MOU with NASDAQ-listed Optimer Pharmaceuticals (OPTR US) to commercialize and distribute its products in China under a revenue sharing model. The partnership will start contributing in 11-18 months; 2) Exclusive marketing and distribution rights from Pharmaco, a US-based global health, consumer and medical product maker, for its Century Multi-Vitamin Tablets and Century Senior Multi-Vitamin Tablets for up to 10 years from June 2007. In 2006, sales of non-prescription multivitamins in China grew 15% to about RMB5b; 3) appointment as an exclusive cough syrup distributor by Europharma Laboratories, a Hong Kong-based pharmaceutical manufacturer, for 10 years from 1 Sep 2007. According to China's Ministry of Health, more than 50m people come down with a cough each year. The company expects sales of RMB6m in the first year and targets to corner up to 30% of the Pholcodine syrup market in three to four years.

New R&D centre to break into CRO

The company's new R&D centre in Nanjing New Town Science and Technology Park will focus on: 1) pharmacokinetic and drug metabolism; 2) synthesis of new chemical compounds; 3) study of new drug formulations and 4) quality control and assurance. Started in Apr 2007, the center is expected to take around 18 months to complete. The company is also expanding its R&D centre in Shanghai and plans to monetize this platform engaging in CRO services. Foreign pharmaceutical companies are increasingly focusing on China and India because of the countries' strong medical infrastructure, low costs and relative ease in recruiting patients with disease under investigation. China has overtaken India as one of the fastest-growing locations for drug trials. According to the US National Institute of Health, China has 274 clinical trials underway and India 260. We expect C&O's CRO services to start contributing in FY6/09.

GMP obtained
Freeze dried powder process

In 3Q FY6/07A, C&O received approval for its new freeze dried powder production capacity (12.0m bottles annually).

Valuation

With its strategic partners in place, aggressive sales network expansion, improving earnings visibility and better regulatory conditions, C&O's prospects look solid. We have a HOLD call on the counter with a target price of S$0.60, representing 15.0x FY6/08F P/E.

Table 16: P&L

Year to Jun (HK$m)	06A	07A	08F	09F	10F
Turnover					
Sale of self-manufactured pharmaceutical products	75.8	105.8	125.4	157.1	188.5
Distribution of pharmaceutical products	269.4	567.2	608.3	703.5	770.9
Sale of technical knowledge	2.2	7.0	7.9	8.7	9.5
	347.4	**680.0**	**741.6**	**869.2**	**968.9**
Cost of sales	(179.3)	(467.5)	(436.4)	(501.2)	(552.8)
Gross profit	168.1	212.4	305.2	368.1	416.1
Other income and gains	3.8	2.9	3.1	3.4	3.7
Selling and distribution costs	(3.6)	(69.7)	(93.3)	(118.0)	(135.3)
Administrative expenses	(30.0)	(64.9)	(71.8)	(79.5)	(88.2)
Other operating expenses	(2.9)	(1.5)	(2.5)	(2.6)	(1.9)
Operating profit	135.4	79.2	140.7	171.3	194.5
Finance costs, net	-	(0.7)	(0.5)	(0.4)	(0.3)
Interest income	3.9	4.3	4.6	5.2	5.8
Profit before taxation	139.3	82.9	144.7	176.2	200.0
Taxation	(21.4)	(6.3)	(11.6)	(14.1)	(18.0)
Profit after tax	**117.9**	**76.6**	**133.1**	**162.1**	**182.0**
Minority interests	0.2	1.0	1.8	2.2	2.4
Profit attributable to shareholders	**118.1**	**77.6**	**134.9**	**164.2**	**184.4**
% chg	*23.0*	*(34.3)*	*73.8*	*21.7*	*12.3*
Dividends	(43.2)	-	-	(49.3)	(55.3)

Source: Company data and SBI E2-Capital

Table 17: Financial Summary

Price	S$0.560
Target price	S$0.6
12 mth range	S$0.23-0.66
Market cap.	US$245.4m
Daily t/o, 3 mth	US$0.1m
Free float %	30.0%
Ticker	COPT SP

Year to 30 Jun	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	Gearing %
06A	118.1	0.202	5.1	14.3	4.8	61.1	2.6	38.7	44.2	Cash
07A	77.6	0.124	(38.7)	23.3	5.9	100.6	-	15.7	15.9	Cash
08F	134.9	0.203	64.4	14.2	13.1	57.1	-	24.3	25.1	Cash
09F	164.2	0.248	21.7	11.7	9.8	50.2	2.6	28.4	29.5	Cash
10F	184.4	0.278	12.3	10.4	8.7	46.2	2.9	29.3	30.8	Cash

Shandong Luoxin (8058 HK) – Not Rated

Growing but valuation appears stretched

Key investment themes are:

- Strong execution in obtaining new drug product permit approvals. Company launched 40 new products in FY12/06 despite the ongoing industry restructuring initiatives.
- Horizontal expansion into sales of raw material active pharmaceutical ingredients (API) further fuelling growth.
- Demonstrating strong growth momentum with 1H FY12/07A net profit up 98.8% YoY at RMB51.4m.
- 20-year patent and production permit for its Rhodiola medicine, which it expects to generate RMB1.0b in revenue over its life cycle. If product launch is successful, it will provide a major boost to an already robust growth outlook.
- Announced a mandate to seek an issue not more than 100.0m new H-Shares in Sep 2007. Issue price will be not more than HK$3.60 per share and not less than HK$2.60 per share. Management also has plans to move from GEM to Main Board in 2008.
- Based on our preliminary estimates, Luoxin is currently trading at 27x FY12/07F P/E, which seems stretched based on current valuations. In our view, we expect the counter to consolidate after the issue of the new H-Shares.

Business focus

Shandong Luoxin (Luoxin) focuses on the development, manufacture and sale of different types of prescription/OTC medicines under its own brands in four major categories: 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.

Outstanding performance 1H FY12/07 performance

Growth picked up further in 1H FY12/07, with net profit up 98.8% YoY at RMB51.4m, after a strong FY12/06 (net profit up 62.9% and turnover up 27.3%). Luoxin's turnover rose 53.7% YoY to RMB 226.0m in 1H, with the net margin widening 5.1pcp to 22.7% and gross margin 2.4 pcp to 44.4%.

Abundant growth drivers

1) New products - the company launched close to 40 new products in FY12/06 and plans another 30 in FY12/07. About 10 drugs are awaiting SFDA approval. 2) Improving revenue mix - higher margin system-specific medicines will account for a higher proportion of revenue. 3) New revenue streams - sales of raw materials such as active pharmaceutical ingredients (APIs) to downstream antibiotic manufacturers. 4) Dropping retail prices – driving demand and sales volume for Luoxin's products.

Aggressive expansion

1) new powder production lines – up from two to seven (from 150m to 500m units) in FY12/06; 2) new workshop to produce Cephalosporin products for oral consumption in FY12/06; 3) bulk drug capacity expanded to 1,200 tonnes in FY12/06; 4) new workshop for lyophilized powder for injection, raising annual capacity from 10m to 60m units in FY12/06; 5) multi-purpose warehouse – entered an agreement with Linyi Meihuajianan to buy 12,689sqm of land in September 2007 for RMB10.0m; 6) sales force expansion from 300 to 1,000 in the next two years.

Potential blockbuster drug to further boost robust outlook

The company received a 20-year patent and production permit for its Rhodiola medicine, which it expects to generate RMB1.0b in revenue over its life cycle. Some of the newly acquired land will be used for a warehouse to store raw materials for Rhodiola, which is expected to be launched by end-FY12/08. The product should provide a major boost to top/bottom lines and margins, adding to an already robust growth outlook.

H-share issue in progress, move to main board likely in 2008

In Sep 2007, the company announced plans to issue not more than 100.0m new H-shares at an issue price of not more than HK$3.60 each and not less than HK$2.60. The 100.0m shares will represent 16.5% of its existing share capital and 14.1% of its enlarged share capital. The issue is subject CSRC approval. Management also has plans to move from GEM to the Main Board in 2008.

Valuation

Our back-of-pad estimate puts Luoxin's FY12/07F net profit at RMB105m, representing a 27x FY12/07F P/E (excluding its new share issue). Though the company is displaying strong growth momentum, current valuations seems stretched.

Table 18: P&L

Year to Dec (RMBm)	04A	05A	06A	1H 06A	1H 07A
Turnover	169.0	249.7	317.9	147.1	226.0
Cost of sales	(71.7)	(144.3)	(175.9)	(85.2)	(125.8)
Gross profit	97.3	105.4	142.0	61.8	100.3
Other income and gains	2.0	1.5	5.5	3.1	4.6
Selling and distribution costs	(27.1)	(21.9)	(23.6)	(12.1)	(12.9)
Administrative expenses	(20.0)	(21.5)	(25.0)	(10.2)	(11.9)
Other operating expenses	-				
Operating profit	52.2	63.6	98.9	42.6	80.0
Finance costs, net	(5.6)	(7.1)	(7.7)	(4.0)	(3.2)
Share of profits and losses of jointly controlled entities	-	-	-	-	-
Share of profits of an associated	-	-		-	-
Exceptionals	-		-	-	-
Profit before taxation	46.6	56.4	91.2	38.6	76.8
Taxation	(18.4)	(19.5)	(31.0)	(12.7)	(25.3)
Profit attributable to shareholders	28.2	36.9	60.2	25.9	51.4
%chg	-	*30.9*	*63.1*	-	*98.5*
Dividends	(48.2)	(12.2)	(12.2)		

Source: Company data

Table 19: Financial Summary

Price	**HK$4.780**	**Year to**	**Net profit**	**EPS**	**EPS**	**PE**	**P/B**	**EV/EBITDA**	**Yield**	**ROE**	**ROCE**	**Gearing**
Target price		**31 Dec**	**RMBm**	**RMB**	**Δ%**	**x**	**x**	**x**	**%**	**%**	**%**	**%**
12 mth range	HK$0.50-5.09	**04A**	28.2	0.061	-	75.6	22.7	48.8	2.3	30.1	26.4	Cash
Market cap.	US$377.4 m	**05A**	36.9	0.079	28.2	59.0	17.3	40.1	0.4	28.7	27.2	Cash
Daily t/o, 3 mth	US$0.2m	**06A**	60.2	0.099	25.7	46.9	13.4	25.8	0.4	32.1	35.4	Cash
Free float %	27.0%											
Ticker	8058.HK/8058 HK											

Guangzhou Pharmaceutical (874 HK) – Not Rated

Leading pharmaceutical company with brands and distribution power

Business focus

Key investment themes are:

- One of China's leading pharmaceutical distributors with a network of over 2,000 hospitals, 5,000 distributors and 1,000 retailers, including 115 self-owned retail stores.
- Owns several of China's time-honoured brands such as Pan Gao Shou (潘高寿), Jing Xiu Tang (敬修堂), Chen Li Ji (陈李济), Cai Zhi Lin (采芝林), Wang Lao Ji (王老吉).
- 1H FY12/07A net profit up 17.3% to RMB151m, driven by sales of branded products.
- Cooperation with Alliance boots will add further brands, while taking advantage of its distribution power.
- The counter is currently trading at HK8.91, representing 24.6x FY12/07F P/E and 19.7x FY12/08F P/E based on market consensus estimates.

Business focus

Guangzhou Pharmaceutical (Guangzhou Pharma) focuses on: 1) manufacturing and sales of Chinese Patent Medicine (CPM); 2) wholesale, retail, import and export of western and Chinese pharmaceutical products and medical apparatus; 3) research and development of natural and biological medicines.

Strong brand, wide network

Guangzhou Pharma owns several China time-honoured brands such as Pan Gao Shou (潘高寿), Jing Xiu Tang (敬修堂), Chen Li Ji (陈李济), Cai Zhi Lin (采芝林) and Wang Lao Ji (王老吉). It has a network of 2,000 hospitals, 5,000 distributors and 1,000 retailers. It owns directly 118 retail chain pharmacies, including 88 "Cai Zhi Lin" (采芝林), which specialize in traditional Chinese medicines, and 27 "Jian Min" (健民), which specialize in chemical medicines.

Solid growth following on industry rebound

With its market leadership and stronghold in Southern China, Guangzhou Pharma has escaped the industry restructuring almost unscathed. Turnover increased 17.3% YoY to RMB5,987m in 1H FY12/07, with gross profit up 11.8% YoY at RMB924m and net profit up 17.3% at RMB151m. The sales of An Shen Bu Nao Ye (安神补脑液) increased 65.0%, Xu Han Ting (虚汗停) 83%, Wang Lao Ji Herb Tea (王老吉凉茶) 105.2% and Ke Chuan Shun Wan (咳喘顺丸) 211.4%.

Cooperation with Alliance Boots

Alliance Boots is a leading health and beauty group partnering with manufacturers and pharmacists in more than 15 countries. Alliance BMP, 80%-owned by Alliance Boots and 20% by NASDAQ-listed Beijing Med-Pharm, plans to acquire 50% of Guangzhou Pharmaceutical Cooperation Group (GP Corp), one of subsidiaries of Guangzhou Pharma, for RMB485.1m, representing 10.2x of GP Corp's net profit of RMB47.7m in FY12/05A. The company completed the capital transfer contract in Jan 2007. Guangzhou Pharma expects to benefit from Alliance Boots' management expertise and introduction of its foreign-branded pharmaceutical products. It expects the acquisition to be finalized by end-FY12/07.

Valuation

The counter is currently trading at HK$8.91, representing 23.6x FY12/07F P/E and 18.9x FY12/08F P/E, based on market consensus estimates.

Table 20: P&L

Year to Dec (RMBm)	04A	05A	06A	1H 06A	1H 07A
Turnover	7709.6	9026.3	10241.0	5101.9	5987.5
Cost of sales	(6313.6)	(7473.0)	(8472.2)	(4275.1)	(5063.3)
Gross profit	1395.9	1553.4	1768.8	826.8	924.2
Other income and gains	65.1	91.6	75.2.	44.1	39.2
Selling and distribution costs	(557.4)	(616.8)	(778.2)	(391.6)	(445.6)
Administrative expenses	(666.7)	(641.4)	(656.5)	(275.4)	(260.5)
Other operating expenses	(27.6)	(16.5)	(14.5)	(3.6)	(3.2)
Operating profit	209.4	370.3	394.8	200.3	254.2
Finance costs, net	(47.2)	(53.6)	(45.4)	(26.5)	(34.1)
Share of profits and losses of jointly controlled entities		-	-	17.6	25.5
Share of profits of an associated	(0.6)	(1.2)	(0.3)	(1.5)	0
Exceptionals			-		-
Profit before taxation	161.7	315.5	349.2	189.8	245.5
Taxation	(110.3)	(107.8)	(118.6)	(52.5)	(84.4)
Profit from continuing operations					
Profit from discontinued operations			-	-	-
Profit after tax	51.4	207.7	230.6	137.3	161.1
Minority interests	(8.6)	(9.9)	(12.5)	(8.5)	(9.9)
Profit attributable to shareholders	42.8	197.8	218.1	128.8	151.2
%chg		*362.1*	*10.3*		*17.4*
Dividends	(20.3)	(56.8	(68.1)	-	-

Source: Company data

Table 21: Financial Summary

Price	HK$8.780
Target price	
12 mth range	HK$9.55-4.15
Market cap.	US$1,448.6m
Daily t/o, 3 mth	US$1.4m
Free float %	45.2%
Ticker	0874.HK/ 874 HK

Year to 31 Dec	Net profit RMBm	EPS RMB	EPS Δ%	PE x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	Gearing %
04A	42.8	0.053	-	160.6	2.7	45.4	0.3	1.7	5.7	Cash
05A	197.8	0.244	360.4	34.9	2.5	28.6	0.8	7.5	9.4	Cash
06F	218.1	0.269	10.2	31.6	2.4	26.6	1.0	7.8	10.0	Cash

Mingyuan (233 HK) – Not Rated

Proxy to China's growing healthcare insurance market

Business focus

Mingyuan Medicare Development Company is a Hong Kong-based pharmaceutical holding company operating in China. It focuses on 1) sales of C-12 protein chips to 600 hospitals and wholesale distributors; 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.

Slight lower than expectation results

In 1H FY12/07, turnover increased 46.9% YoY to HK$107.6m, while net profit rose 18.7% YoY to HK$52.9m. The gross margin narrowed 9.9pcp to 78.7% and net margin 11.7pcp to 49.1%. The top line was boosted by a HK$18.1m maiden contribution from Mingyuan's healthcare business. Its cancer market business was solid with turnover growth of 22% YoY to HK$89.6m. In 1H FY12/07, its sales of protein chips accounted for 83.2% of total revenue and other healthcare products for 16.8%.

Unique and efficient early cancer detection system

C-12 is the unique protein chip system in the world developed by Shanghai HealthDigit Company Limited (HealthDigit) to detect multiple types of cancer simultaneously. Capable of detecting up to 12 tumor markers at the same time, C-12 protein chips can detect up to 10 cancers at their asymptomatic stage with a success rate of about 80.0%. The C-12 protein chip set was awarded the Class 1 Drug Certificate and Manufacturing Certificate by the SFDA in December 2001 and was launched in China in late 2002. The company has a first mover advantage as there is no identical product in the market.

Huge market potential for cancer markers

According to China's Health Statistical Yearbook of 2006, cancer was the top cause of death in the country with a rate of 126.4 per 100,000 people and accounted for 24% of deaths in 2004.

China Life deal is ramping up

The company entered into a cooperation agreement with China Life Shanghai (CLS) for the use of its multi-tumor marker detection systems in CLS's "Cancer Care Insurance Policy" on 19th December 2006. From March 2007, the company's new channel to distribute the chips through China Life's cancer insurance policies generated sales of 120,000, accounting for 12.9% of the total. In our view, this channel, while possessing excellent opportunities, is still at a ramp up stage. The insurance product is only on sale in Shanghai. If successful, China Life will consider rolling the product out in other parts of China.

New business started to make contribution

In June 2006, the company acquired 51% interest of Shanghai Weiyi Hospital Investment and Management Co. Ltd which is mainly engaged in: 1) operation of a 228-bed woman and infant specialty hospital in Shanghai and 2) distribution of DNA HPV diagnostic kits for cervical cancer screening. Weiyi's main strategic aim is to set up of a flagship center for cervical cancer screening. For 1H FY12/06, the new business contributed revenue of HK$18.1m and net profit of HK$3.1m. More than 8,300 HPV DNA diagnostic kits were sold.

Key risk is the effectiveness of product

The key risk of Mingyuan is the effectiveness of its cancer markers. Recent comments/reports questioned the effectiveness of C-12 protein chips. Other risks include execution risks of its new insurance partner channels and new product.

Valuation

The counter is currently trading at 32.1x FY12/07F P/E and 22.2x FY12/08F P/E, based on consensus estimates. In our view, current valuations are fair given some of the risks.

Table 22: P&L

Year to Dec (HK$m)	04A	05A	06A	1H 06A	1H 07A
Turnover	523.6	127.0.	160.8	73.3	107.6
Cost of sales	(426.7)	(11.7)	(19.5)	(8.3)	(22.9)
Gross profit	96.8	115.2	141.3	65.0	84.7
Other income and gains	15.2	23.4	20.6	18.7	10.2
Selling and distribution costs	(6.0)	(5.8)	(9.2)	(3.8)	(7.4)
Administrative expenses	(35.3)	(42.0)	(43.6)	(18.1)	(24.9)
Other operating expenses	4.2	(13.7)	2.6		
Operating profit	74.9	77.2	111.7	61.8	62.6
Finance costs, net	(2.8)	(5.0)	(16.7)	(8.2)	(7.9)
Interest income	-	-	-	-	-
Profit before taxation	72.0	72.1	95.0	53.5	54.7
Taxation	(4.8)	-	(19.0)	(8.6)	(0.7)
Profit after tax	67.3	72.1	76.1	44.9	54.0
Loss attributable to discontinued activities	-	(2.1)	(3.2)	-0.6	-
Minority interests	0.2	(0.1)	(0.6)	(0.3)	(1.1)
Profit attributable to shareholders	67.0	70.1	73.6	44.6	53.0
% chg	98.8%	4.5%	4.3%	-	18.8
Dividends	-	-	(26.9)	(26.9)	(27.4)

Source: Company data

Table 23: Financial Summary

		Year to 31 Dec	Net profit HK$m	EPS HK$	EPS Δ%	PE x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	Gearing %
Price	**HK$1.270**											
Target price												
12 mth range	HK$0.69-1.79	**04A**	67.0	0.025	-	50.8	8.9	44.0	-	17.5	15.2	Cash
Market cap.	US$456.3m	**05A**	70.1	0.024	(3.4)	52.6	6.9	34.1	-	16.0	16.3	Cash
Daily t/o, 3 mth	US$3.7m	**06A**	73.6	0.025	4.9	50.1	6.0	29.0	0.7	13.9	16.7	Cash
Free float %	25.0%											
Ticker	0233.HK/ 233 HK											

Table 24: Valuation comparison

Company name	Ticker	Country	Mkt Cap (US$m)	Last price (local)	Est Curr Yr P/E (x)	Est Next Yr P/E (x)	ROE (%)
HK Listed							
China Healthcare							
China Renji	648 HK	China	235.3	0.162	na	11.8	na
HK Healthcheck	397 HK	China	115.0	0.200	na	na	na
Town Health	8138 HK	China	238.5	0.112	13.9	na	na
Huaxia	8143 HK	China	52.0	0.24	17.1	10.9	
Average					*15.5*	*11.4*	
China Pharma							
Mingyuan Medicare	233 HK	China	456.3	1.270	32.1	22.2	13.9
Hua Han Bio-Pharma	587 HK	China	250	2.300	14.0	10.1	16.3
Shangdong Xinhua	719 HK	China	360.3	2.95	na	na	1.7
Guangzhou Pharma	874 HK	China	1448.6	8.780	23.6	18.9	7.8
China Pharma	1093 HK	China	775.2	3.980	14.7	14.1	0.6
Sino Bio-Pharma	1177 HK	China	436.5	1.450	23.4	19.1	7.5
Wuyi Pharma	1889 HK	China	317.8	1.47	9.6	9.1	58.5
China Shineway	2877 HK	China	616.5	5.76	12.7	18.6	19.6
Shangdong Luoxin	8058 HK	China	377.4	4.780	na	na	32.1
Average					*18.5*	*16.0*	
Others							
Simcere Pharmaceutical	SCR US	China	1041.9	16.7	27.7	20.8	54.2
C&O Pharmaceutical	COPT SP	China	253.4	0.560	13.7	11.4	15.7
Asia pharmaceutical	APHM SP	China	36.8	0.590	11.8	8.9	15.6
Average					*17.7*	*13.7*	
Sector average					*17.9*	*14.7*	

Source: Bloomberg

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BUY	: absolute upside of >10% over the next six months
HOLD	: absolute return of -10% to +10% over the next six months
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