



Hua Xia Healthcare

Polaris HK Research Department

Tel: (852) 3555-0779

8 April 2011

Price: HK\$0.415

Stock codes: 8143.HK/8143 HK

Company introduction

Hong Kong

HSI (07/04/11): 24281

Injected with essential nutrients

- **China's pharmaceutical market is expected to grow 20% pa until 2016.** China's healthcare reform and aging population are the major driving forces behind the nation's drug sales and healthcare services. China's pharmaceutical market grew from US\$18.7bn in 2005 to US\$37.6bn in 2009, representing a CAGR of 19% over the period and is estimated to grow at a 09-16 CAGR of 20.3%.
- **Fujian's leading drug wholesaler and distributor.** GEM listed Hua Xia Healthcare (8143.HK, Hua Xia) has transformed into a drug wholesaler and a pharmacy retail chain operator after the asset injection by its major shareholder. With the expectation of winning more tenders to supply drugs to local hospitals in Mar11, we expect Hua Xia to turnaround in FY11 and record a core net profit of HK\$57m.
- **Target at FY11 core PER 12x, 35% upside.** Hua Xia is the cheapest among its peers in terms of PER. The company has a small market capitalization and is illiquid, it is not yet on most investors' radar screen. However, its drug wholesale and retail businesses should provide steady growth and we believe that it is a good investment for the long term. We initially set our target price at FY11 core PER of 12x. This translates into a target price of HK\$0.56/share, a potential upside of 35%.

Earnings highlights

Year-end 31 March	2008	2009	2010	2011F	2012F
Sales (HK\$ m) ⁽ⁱ⁾	114.2	170.1	179.8	1,483.0	1,594.3
Growth (%) ⁽ⁱ⁾	238.8	49.0	5.7	724.8	7.5
Core net profit (HK\$ m)	(21.0)	(200.5)	(211.2)	57.3	68.1
Growth (%)	n.a.	n.a.	n.a.	n.a.	18.8
Net profit (HK\$ m)	(17.9)	(193.4)	(211.4)	71.5	77.3
Growth (%)	n.a.	n.a.	n.a.	n.a.	8.1
Fully diluted core EPS (HK\$)	(0.12)	(1.03)	(0.44)	0.05	0.06
Growth (%)	n.a.	n.a.	n.a.	n.a.	18.8

Note (i): Figures are based on continuing operation, sales from discontinued operation in 2008 is HK\$21.8m
Source: Company, Polaris Financial Group ("Polaris") estimates

Valuations & ratings

Year-end 31 March	2008	2009	2010	2011F	2012F
FD Core PER (x)	n.a.	n.a.	n.a.	8.9	7.5
FD PER (x)	n.a.	n.a.	n.a.	7.2	6.6
EV/EBITDA (x)	(131.3)	(3.0)	(2.6)	4.4	4.0
Price/Book value (x)	0.1	0.2	0.3	0.6	0.5
Operating margin (%)	(3)	(104)	(114)	6	7
ROE (%)	(3.7)	(59.0)	(30.0)	7.9	7.8
Total debt/Equity (%)	7.1	2.1	41.5	32.1	29.3

Source: Company, Polaris estimates

Overweight

Current price (07/04/11):	HK\$0.415
Target price:	HK\$0.56
Potential upside:	35%

Share information

52-wk hi/low:	HK\$1.314/HK\$0.37
Total outstanding shares:	672m
Current market cap:	HK\$279m (US\$36m)
Avg 52-wk daily vol:	HK\$0.96m (US\$0.12m)

Major shareholders (%)

Management	29.14%
Public	70.86%

1-3QFY11 results highlights

Period-end 31 Dec	FY10	FY11
Sales (HK\$m)	98.5	1,096.4
Gross profit (HK\$m)	64.2	157.2
Net profit (HK\$m)	-0.3	43.6
Basic EPS (HK\$cents)	-0.10	4.46

Share price performance



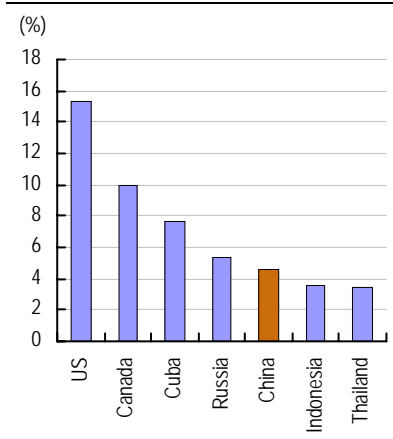
Source: Bloomberg

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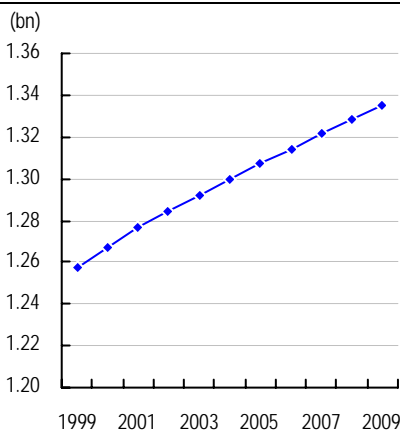
Industry Analysis

Figure 1: Healthcare expenditure as a percentage of GDP in different countries (2006)



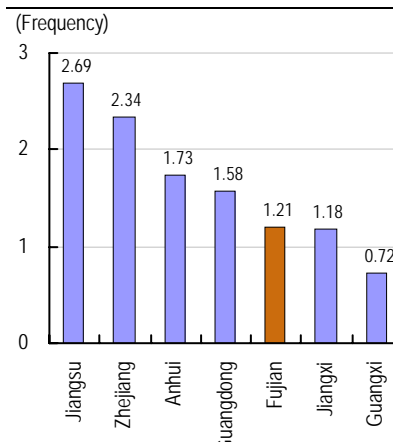
Source: Ministry of Health, China

Figure 2: Population of China (1999-2009)



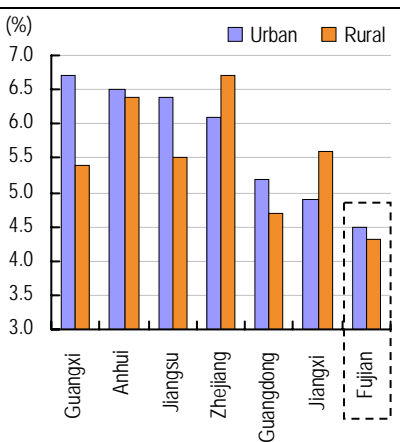
Source: Ministry of Health, China

Figure 3: Number of Grade 2 (二級) hospitals per 1000 km² in 2008



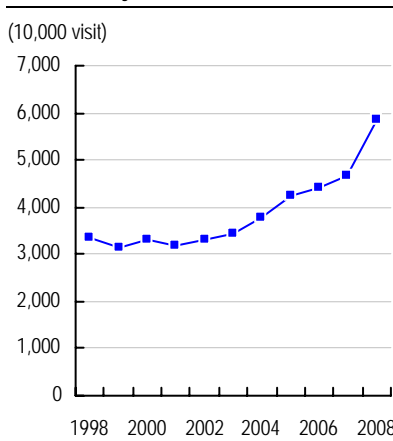
Source: Ministry of Health, China

Figure 4: Medical expenses as a % of consumption expenses in China in 2008 (%)



Source: Ministry of Health, China

Figure 5: Number of visits to hospitals at country level in Fujian



Source: Fujian Statistical Yearbook, 2009

Figure 6: Number of healthcare institutions in Fujian

Year	Hospital	Prevention & treatment centre	Sanitation supervision centre	Nursing station
2004	8,672	37	17	6,591
2005	7,932	34	33	5,920
2006	9,652	31	46	7,623
2007	9,230	31	50	6,888
2008	7,773	26	63	5,323

Source: Fujian Statistical Yearbook, 2009

Healthcare investment is set to rise

Healthcare reform has been one of the most important issues under China's 12th 5-Year Plan. In developed countries such as US, healthcare expenditure accounted for nearly 16% of the country's GDP. China is comparatively low as healthcare expenditure only took up less than 5% of the GDP in 2008 (see Fig 1). One of the objectives under China's healthcare reform is to improve the social medical insurance coverage to above 90% by 2011 and further increase to 99% within 2 years. This creates investment opportunities within the sector on the back of increasing amount of healthcare expenditure.

Society structure ignites drug sales

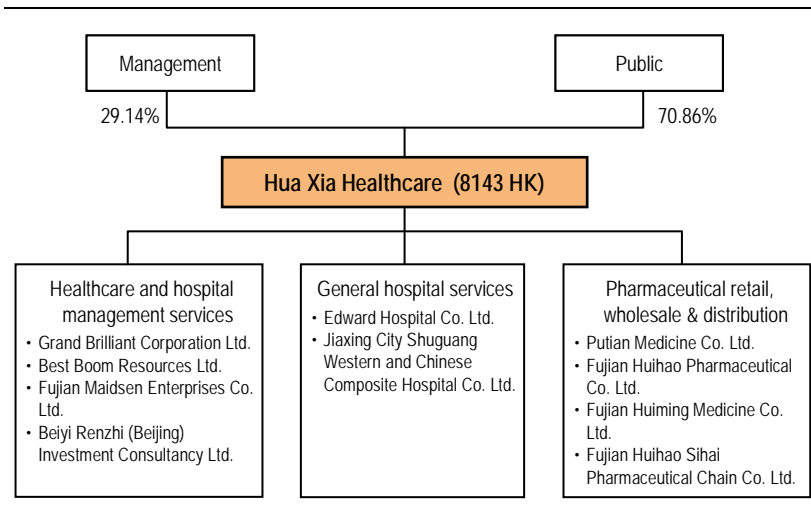
From 2005 to 2009, China's population has grown from 1.31bn to 1.33bn, with proportion of elderly people aged 65 or above jumped from 7.7% to 8.5% over the same period. China's aging population, accelerating urbanization, together with wider medical coverage are driving demand for drug and hospital services. According to Frost and Sullivan, China's pharmaceutical market grew from US\$18.7bn in 2005 to US\$37.6bn in 2009, representing a CAGR of 19% and is estimated the amount will reach US\$137.1bn in 2016, a CAGR of 20.3% from 2009-16.

Drug distribution - regional business

Most drug distributors of hospitals and clinics in China are regional players. There are only a few nationwide drug wholesalers/distributors such as Sinopharm Group (1099 HK). As industry general practice, drug manufacturers are required to distribute their products through a wholesaler/distributor. In order to win contracts and sell their products to hospitals, drug manufacturers are required to submit their proposals through a bidding process. Besides pricing and other terms, they are also required to name which wholesaler/distributor they will be using. Fujian is an under-developed coastal province with low hospital penetration and its medical spending accounted for less than 4.5% of consumption expenses (Fig. 3&4). Historical figures show that Fujian's medical expenditure has risen at a rate of about 40% p.a. since 2008. Hua Xia is one of Fujian's largest drug distributors with strong presence in 4 of the 9 areas in Fujian. Therefore, the company is a strong candidate to be chosen by many drug manufacturers as their partner for distribution.

Company & Financial Analysis

Figure 7: Hua Xia's corporate structure



Source: Company

Figure 8: Hua Xia's consolidated profit and loss (HK\$m)

Year-end 31 March	2008	2009	2010	2011F	2012F
<i>Sales breakdown (%):</i>					
Hospital Management	40%	8%	1%	0%	0%
Hospital services	59%	92%	70%	7%	6%
Drug distribution	-	-	29%	93%	93%
Others	1%	-	-	-	-
Total consolidated sales⁽ⁱ⁾	114.2	170.1	179.8	1,483.0	1,594.3
Total COGS	(39.6)	(72.8)	(115.4)	(1,263.9)	(1,360.1)
Gross profit	74.6	97.3	64.4	219.0	234.2
Other revenue/income	7.6	2.1	1.3	10.0	10.5
Operating expenses	(86.2)	(276.3)	(269.8)	(135.0)	(135.5)
Operating profit	(4.0)	(176.8)	(204.1)	94.1	109.2
Interest income	2.6	0.4	0.5	0.9	1.8
Interest expense	(3.4)	(1.8)	(1.3)	(10.2)	(10.2)
Net operation income/(expenses)	0.0	0.0	0.0	0.0	0.0
Income from associates	0.0	0.0	0.0	0.0	0.0
Pretax profit	(4.8)	(178.2)	(204.9)	84.8	100.8
Taxation	(6.2)	(12.2)	(1.7)	(21.2)	(25.2)
Minority interests	(10.1)	(10.1)	(4.6)	(6.3)	(7.5)
Core net profit	(21.0)	(200.5)	(211.2)	57.3	68.1
Extraordinaries ⁽ⁱⁱ⁾	3.2	7.1	(0.2)	14.2	9.2
Net profit	(17.9)	(193.4)	(211.4)	71.5	77.3

Major ratios:

Sales growth (%) ⁽ⁱ⁾	238.8	49.0	5.7	724.8	7.5
Core net profit growth (%)	n.a.	n.a.	n.a.	n.a.	18.8
Net profit growth (%)	n.a.	n.a.	n.a.	n.a.	8.1
Gross margin (%)	65.3	57.2	35.8	14.8	14.7
Operating profit margin (%)	(3)	(104)	(114)	6	7
Net margin (%)	(18.4)	(117.9)	(117.5)	3.9	4.3
Tax rate (%)	(386.7)	(7.1)	(0.8)	25.0	25.0

Major drivers:

No. of retail stores	-	-	90	100	110
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Note (i): Figures are based on continuing operation, sales from discontinued operation in 2008 is HK\$21.8m; (ii): Extraordinaries include profit from discontinued business, forex gain and profit guarantee

Source: Company, Polaris estimates

Fujian's leading drug distributor

Hua Xia Healthcare (8143.HK, Hua Xia) was incorporated in the Cayman Islands in 2001 and listed on Hong Kong's GEM board in 2002. The company was formerly known as "Grandy Corporation" but had changed its name in 2006. After several company reorganizations, the company now principally engages in the pharmaceutical wholesales and distribution, pharmaceutical retail chain business, provision of hospital healthcare and management services in China.

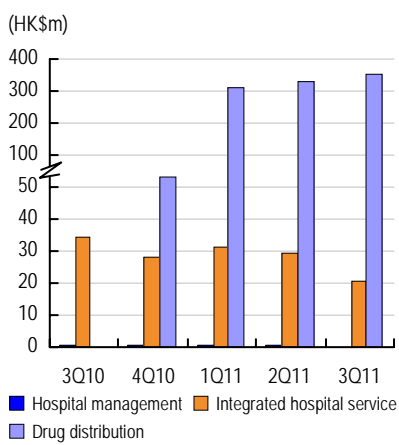
Started as hospital service provider

Hua Xia started its hospital management and services in 2006. The company currently holds two hospitals, namely Chongqing Edward Hospital and Jiaxing Shuguang Hospital. Through several years of restructuring, the management has found the right business model and both hospitals are profitable. In addition, Hua Xia also engages in the management of Zhuhai Jiulong Hospital by contracting with prefixed acquisition cost, and pending on satisfactory performance of the hospital, Hua Xia has the option to become a shareholder. The directors are considering replicating this business model by cooperating with other hospitals.

Injected drug wholesale and retail

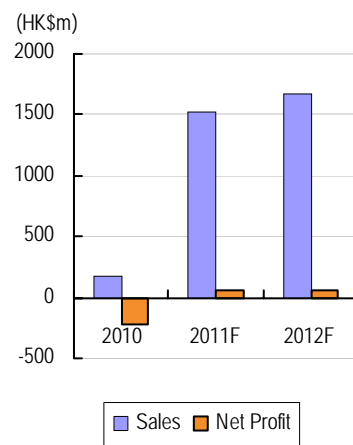
In March 10, Hua Xia acquired Huihao Medicine Wholesale Group and Huihao Sihai Pharmaceutical retail chain from its major shareholder. The HK\$600m purchase was settled by cash, promissory note and convertible preference shares. Huihao is one of Fujian's leading distributors for pharmaceutical and healthcare products. It has established good relationship with drug manufacturers. More importantly, because of Huihao's large operating scale, drugs are bought at low prices through bulk purchases and its customers are ensured to have good quality drugs and stable medical supply. The company owns a pharmaceutical distribution centre, occupying an area of 16,000m², making it the largest drug warehouse in Fujian. For its retail business, Huihao Sihai is Fujian's largest pharmaceutical retail chain with 90 stores (point-of-sales) under its operation and another 3 to commence business shortly. Its largest retail store occupies a space of 250m² and sells over 4,000 different kinds of medicine.

Figure 9: **Sales breakdown by quarter (3QFY10-3QFY11)**



Source: Polaris estimates

Figure 10: **Sales and net profit (FY10 – FY12F)**



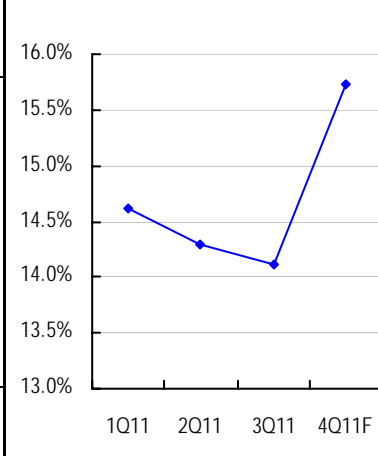
Source: Polaris estimates

Figure 11: **Number of outstanding shares & convertible derivatives**

Item	Number of shares involved (million)
Ordinary Shares	672.4
Convertible Preference Shares	510
Convertible Note	3.4
Share option	46.8
Fully diluted shares	1,232.6

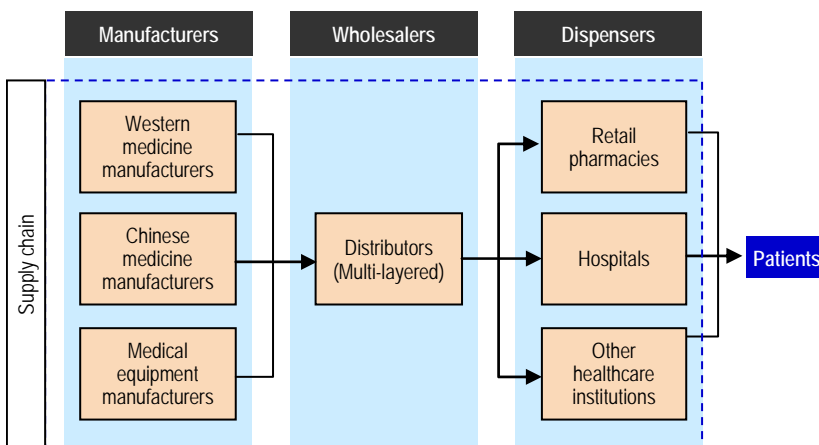
Source: Polaris estimates

Figure 12: **Gross Margin (1QFY11 – 4QFY11F)**



Source: Company, Polaris estimates

Figure 13: **Supply chain outlook**



Source: Polaris

Drug business to dominate

Hua Xia sales are mainly divided into three business segments namely: 1) drug sales from pharmaceutical wholesale, distribution, and retail; 2) integrated hospital services, and 3) healthcare and hospital management. Since Huihao was injected into Hua Xia in Mar10, drug sales have become the main business of the company. For the period of 1-3QFY11 (Apr-Dec 2010), total sales were HK\$1,096m. Drug sales were HK\$1,014m, accounting for 93% of total. Within this segment, about 20% was from retail sales. We estimate that drug sales to account for around 93% of total sales in 2011. Drug sales have been growing at a pace of between 6% to 10% qoq in the past three quarters. The company will likely win another tender in Mar11 to distribute drugs to local hospitals, which should gradually boost sales in coming years. All in all, we forecast overall sales to be at Rmb1,483m in FY11, a growth of 725% yoy.

Gross margin to improve in 4QFY11

As Hua Xia's sales are dominated by its drug business, overall gross profit margin is mainly a reflection of it. Under the drug business, gross profit margin of its wholesale to hospital is estimated to be around 5%-8% whereas its retail business is around 20-30%. In 1-3QFY11 (Apr-Dec 10), gross profit was recorded at HK\$157m, a surge of 145% yoy. This was mainly boosted by the drug business. 1-3QFY11 (Apr-Dec 10) overall gross profit margin was 14.3%. We expect gross margin to improve in 4QFY11 (Jan-Mar 2011) as we anticipate that its retail business will expand at a relatively faster pace. For FY11, we estimate overall gross profit margin to reach 14.8%.

FY11 core NP to reach HK\$57m

After the asset injection of Huihao, Hua Xia has been producing steady quarterly net profit. 1-3QFY11 core net profit was HK\$43.6m (3QFY11 net profit was HK\$15m). We estimate FY11 core net profit to rise to HK\$57.3m.

After Hua Xia's rights issue in Oct10 and a 10-to-1 share consolidation in Jan11, total shares outstanding was 672m shares. The company also has convertible preference shares, convertible notes and employee's share options (see figure 11). The largest shareholder holds 28% of the outstanding shares and CP which is very unlikely to convert into shares as this will trigger a general offer. Although the CP conversion will unlikely materialize, we have to take into the account of this potential share dilution in our EPS calculation.

Figure 14: **Hua Xia's consolidated cashflow (HK\$m)**

Year-end 31 March	2008	2009	2010	2011F	2012F
Net profit	(17.9)	(193.4)	(211.4)	71.5	77.3
<i>Non-cash items:</i>					
Depreciation & amortization	7.1	11.6	12.2	14.6	16.9
Others	(83.7)	131.0	(5.2)	0.0	0.0
Total non-cash items	(76.6)	142.6	7.0	14.6	16.9
Gross operating cash flow	(94.5)	(50.8)	(204.5)	86.0	94.1
Working capital changes	9.2	175.0	169.5	(56.7)	(0.3)
Cash from operations	(85.3)	124.2	(35.0)	29.3	93.8
Investing Activities					
Fixed assets, net	(11.9)	(13.6)	(6.8)	(9.0)	(8.5)
Investment & others, net	(53.8)	(117.5)	5.3	(0.7)	0.0
Financing Activities					
Issue of shares	214.9	45.0	0.0	124.8	0.0
Net change in borrowings	(18.4)	(29.0)	6.3	(0.0)	0.0
Dividends & others	(2.6)	(0.6)	2.0	6.3	7.5
Change in net cash	42.9	8.4	(28.2)	150.7	92.8
Affect of exchange rates	10.5	2.0	(0.6)	9.2	9.2
Cash b/f	24.8	78.1	88.5	59.7	219.6
Cash c/f	78.1	88.5	59.7	219.6	321.6

Source: Company, Polaris estimates

 Figure 15: **Hua Xia's consolidated balance sheet (HK\$m)**

Year-end 31 March	2008	2009	2010	2011F	2012F
Trade debtors	44.3	3.9	209.4	372.4	392.5
Stocks	2.6	3.7	95.2	96.4	103.6
Cash & near cash	83.3	93.8	77.0	226.6	328.6
Other current assets	100.0	14.4	31.8	40.1	40.1
Current assets	230.3	115.7	413.4	735.5	864.8
Trade creditors	21.9	12.5	197.8	312.3	335.8
Debt	2.8	7.0	48.0	48.0	48.0
Other current liabilities	25.9	19.3	55.2	46.2	49.7
Current liabilities	50.6	38.7	301.0	406.6	433.5
Net current assets/(liabilities)	179.7	77.0	112.3	329.0	431.3
Fixed assets, net	31.4	43.7	43.4	37.9	29.5
Other LT assets	324.9	235.6	825.9	826.0	826.0
Long-term debt	0.0	0.0	240.5	240.5	240.5
CBs	31.4	0.0	3.7	3.7	3.7
Other LT liabilities	26.9	28.4	33.5	39.2	46.7
Total net asset value	477.8	327.8	704.0	909.4	995.9
Capital	89.9	224.8	466.4	591.2	591.2
Reserves	387.9	103.1	237.6	318.2	404.7
Shareholders' funds & MI	477.8	327.8	704.0	909.4	995.9
Major ratios:					
A/R turnover (days)	31	5	256	66	66
Inventory turnover (days)	29	22	337	28	28
A/P turnover (days)	256	73	371	91	91
Net cash/(debt) (HK\$ m)	44	81	(233)	(73)	29
Net gearing (%)	Net cash	Net cash	33.0	8.0	Net cash
Total debt/Equity (%)	7.1	2.1	41.5	32.1	29.3
NAV per share (HK\$)	2.8	1.7	1.5	0.7	0.8
Price/book (x)	0.1	0.2	0.3	0.5	0.5
ROE (%)	(3.7)	(59.0)	(30.0)	7.9	7.8
ROA (%)	(3.0)	(49.0)	(16.5)	4.5	4.5
ROIC (%)	(4.8)	(42.6)	(30.3)	6.9	6.5

Source: Company, Polaris estimates

 Figure 16: **Hua Xia's ROE evolution**

Year-end 31 March	2008	2009	2010	2011F	2012F	Comment
EBIT margin (%)	(9.6)	(105.7)	(116.2)	6.9	7.0	Increasing portion of retail drug business will improve EBIT margin
Capital turnover ratio (x)	0.3	0.4	0.3	1.3	1.2	Turnover surges along with expansion of retail network
Financial cost ratio (x)	1.1	1.0	1.0	0.9	0.9	Stable financial cost ratio
Financial structure ratio (x)	0.7	1.4	1.0	1.2	1.3	Higher debt level from retail network expansion
Tax effect ratio (x)	1.5	1.1	1.0	0.8	0.8	Tax rate to be around 25% going forward
ROE (%)	(3.7)	(59.0)	(30.0)	7.9	7.8	ROE returns to positive in FY11 and stays at similar level going forward
ROIC (%)	(4.8)	(42.6)	(30.3)	6.9	6.5	ROIC below WACC of 9%, the company is not creating value

Source: Company, Polaris estimates

Drug business inflates balance sheet

Hua Xia did not disclose its financial position at the end of 3QFY11 (i.e. Dec-end 10). As of end of 1HFY11 (i.e. Sep-end 2010), Hua Xia had cash and bank balance of HK\$84m and HK\$602m of total liabilities. With the inclusion of the drug business, inventory level rose to HK\$96m. Management indicated that when drug under its inventory expires, drug manufacturers have agreed to recall and replace them with new drugs at no additional costs. Therefore, we expect there will be very little inventory write-offs going forward. Hua Xia has this advantage over other small wholesales if not for the large operating scale and bargaining power of Huihao. With the rights issue in Oct10, we estimate that the company will see its net gearing ratio decline to 8% by the end of FY11.

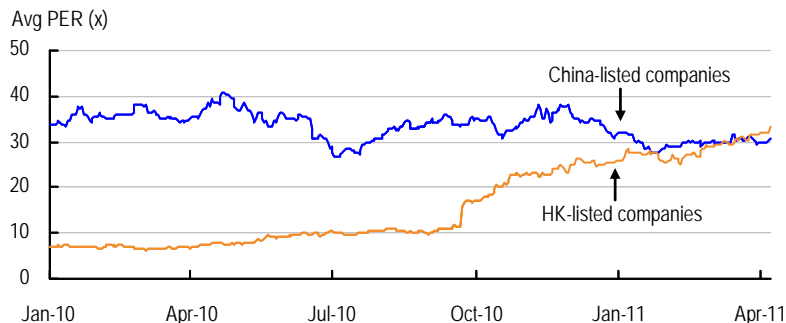
No immediate funding pressure

During 1HFY11 (i.e. Apr–Sep 10), Hua Xia had an operating cash inflow of HK\$15.2m. In Oct10, Hua Xia raised approx. HK\$93.2m through a 3-for-1 rights issue. Proceeds were used to repay shareholder's loan and used for general working capital. After the rights issue, we believe that there is no immediate need for funding in the short to medium term.

Huihao Sihai is restructuring its retail network. Currently, it has 90 retail drug stores in operation. Another 3 are waiting for drug sale permits from the authority. On the other hand, around 200 franchised small drug stores were closed in 2010. This move was to ensure the high quality of products and services provided and to improve management control. Going forward, Hua Xia is planning to set up 10 to 15 retail shops each year in the next two years. It is estimated to cost about Rmb0.4m-0.5m to set up a new retail store. To be conservative, we estimate FY11 (i.e. Apr10– Mar11) capex to be around HK\$9m.

Valuations & PER comparables

Figure 17: Peer companies' 12-mth forward PERs



Source: Company, Polaris estimates

Figure 18: Hua Xia's peer group description

Company	Listed	Ticker	Principle business
Sinopharm Group	HK	1099 HK	pharmacy distribution company which owns several pharmacy enterprise groups
Hua Xia Healthcare	HK	8143 HK	provides hospital services, hospital management services and pharmaceutical distribution
Guangzhou Pharmaceutical	HK	874 HK	manufactures and sells Chinese patent medicine, and exports pharmaceutical products
Sino Biopharmaceutical	HK	1177 HK	pharmacy distribution company which owns several pharmacy enterprise groups
China Shineway Pharmaceutical	HK	2877 HK	researches, develops, produces, and sells biopharmaceutical products
Nanjing Pharmaceutical	Shanghai	600713 CH	distributes & manufactures medicines and medical apparatus
Shanghai Fosun Pharmaceutical	Shanghai	600196 CH	develops, manufactures, and sells modern Chinese medicines and western pharmaceuticals.
Tianjin Tasy Pharmaceutical	Shanghai	600535 CH	manufactures genetic medicines, Chinese traditional medicines, and medical instruments,
Jiangsu Kanion Pharmaceutical	Shanghai	600557 CH	researches, produces, and sells Chinese medicines
Zhejiang Huahai Pharmaceutical	Shanghai	600521 CH	manufactures and markets Chinese traditional healthcare products

Source: Companies, Polaris

Figure 19: Hua Xia's global peer group comparison

Companies ⁽ⁱ⁾	Market cap (US\$m)	FY09 OP margin (%)	FY10E OP margin (%)	FY09 NP growth (%)	FY10E NP growth (%)	FY09 PER ⁽ⁱⁱ⁾ (x)	FY10E PER ⁽ⁱⁱ⁾ (x)	FY11F PER ⁽ⁱⁱ⁾ (x)	FY10E yield (%)	FY10E Price/Bk (x)	FY10E ROE (%)
HK-listed companies											
Sinopharm Group	8,240	3.3	3.6	43.9	56.9	50.9	41.7	30.2	0.6	4.6	11.5
Hua Xia Healthcare	36	(104)	(114)	n.a.	n.a.	n.a.	n.a.	8.9	0.0	0.3	(30.0)
Guangzhou Pharmaceutical	1,151	1.3	4.4	18.2	32.5	35.2	26.3	20.1	0.7	2.1	8.1
Sino Biopharmaceutical	1,724	24.3	23.7	33.4	34.3	30.9	26.8	21.7	2.2	3.7	16.7
China Shineway Pharmaceutical	2,324	43.6	40.5	92.7	4.6	19.9	19.2	15.7	2.0	4.8	26.9
HK-listed average	2,695	(6.3)	(8.4)	47.1	32.1	34.2	28.5	19.3	1.1	3.1	6.6
China-listed companies											
Nanjing Pharmaceutical	625	1.2	0.5	52.4	(27.6)	76.9	89.1	61.4	-	3.9	3.2
Shanghai Fosun Pharmaceutical	3,674	4.3	30.6	261.6	(56.6)	9.4	22.4	18.6	2.1	2.9	12.3
Tianjin Tasy Pharmaceutical	2,939	10.8	10.7	23.8	32.5	57.6	43.9	34.9	1.2	7.9	18.5
Jiangsu Kanion Pharmaceutical	1,052	17.2	16.9	12.9	19.5	43.2	34.2	25.9	0.8	5.6	15.4
Zhejiang Huahai Pharmaceutical	1,050	19.5	14.7	9.9	(1.4)	41.9	44.6	32.2	0.4	3.9	12.1
China-listed average	1,868	10.6	14.7	72.1	(6.7)	45.8	46.8	34.6	1.1	4.8	12.3
Aggregate average	2,282	2.2	3.2	61.0	10.5	40.7	38.7	27.0	1.1	4.0	9.5

Source: Bloomberg, Companies, Consensus estimates, Polaris estimates

Notes: (i) All ratios are calendarised (except for Hua Xia Healthcare); (ii) n.a. under PER means loss-making; Core PER for Hua Xia Healthcare

Very few comparable to Hua Xia

Hua Xia can be seen as a healthcare conglomerate as the company is engaged in drug wholesale, retail, and hospital management services. Its business model is quite unique as most of the corporations are less diversified. However, we believe competition within Fujian's pharmaceutical industry is intensifying. Large national distributor Sinopharm Group has a presence in Fujian and Nanjing Pharmaceutical recently expanded its business to Fujian. Nanjing Pharmaceutical, an A-share company, is trading at FY11 PER of 61x, top-end of our selected peers. We have also selected a few HK-listed pharmaceutical companies as Hua Xia's peer. Our selected peers are trading between the FY11 PER range of 15x to 61x. We believe Hua Xia's closest peers are small scale HK-listed healthcare companies such as Guangzhou Pharmaceutical and China Shineway Pharmaceutical.

Target at FY11 core PER 12x

Hua Xia is the cheapest among its peers in terms of PER. The company has a small market capitalization and is illiquid, it is not yet on most investors' radar screen. However, its drug wholesale and retail businesses should provide steady growth and we believe that it is a good investment for the long term. We initially set our target price at FY11 core PER of 12x. This translates into a target price of HK\$0.56/share, a potential upside of 35%.

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