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Main Board Listing – Research

盈德氣體集團有限公司
Yingde Gases Group Company Limited [Stock Code: 02168]

Global Coordinator : Goldman Sachs

Joint Sponsors, Joint Bookrunners & Joint Lead Managers : Goldman Sachs Morgan Stanley

Sector : Materials
Business : Production and sale of industrial gases

Total share offer: *452,310,000* shares
(25.0% of the enlarged share capital)
Public Offer: *45,231,000* shares (10%)
Placing: *407,079,000* shares (90%)
Greenshoe: *67,846,500* shares

Price: HK$6.03 – HK$7.91 per share
Market Cap: HK$10.9 billion – HK$14.3 billion
Pro forma fully diluted FY09E P/E: 20.1x – 26.4x
Company guidance on FY09E net profit: not less than RMB450 million
Adjusted NTA per share: RMB1.65 – RMB1.95
Staffing: 920 (as of 30th June 2009)

HK Public Offer period:
24th Sep 2009 – 29th Sep 2009 noon
Receiving bank: Bank of China (HK)
Standard Chartered (HK)
Share registrar: Computershare Hong Kong Investor Services Limited.
Listing date: 8th October 2009

Business of Yingde Gases

The Group is the largest independent industrial gas supplier in the Mainland, in terms of revenue of 2008. It is mainly engaged in the production, supply and distribution of a variety of industrial gas products to its onsite and merchant customers from different locations in China. The Group's major industrial gas products included oxygen, nitrogen and argon.

Yingde's onsite customers are the customers for whom the Group has its gas production facilities located on or in close proximity to their premises and to whom the Group supplies industrial gases directly. The merchant customers are generally liquid gas distributors who purchase industrial gases from Yingde in spot market. Yingde's on-site customers are primarily iron and steel makers, as they use the gas products as part of their production process. The Group enters into long-term take-or-pay gas supply contracts with its on-site customers, generally with durations of 15-25 years.

The Group currently operates 20 industrial gas production facilities across the Mainland, while another 12 plants are under development.

Shareholders after Listing (Assuming the over-allotment option is not exercised)

Baslow – 100% owned by a family trust of Mr. Trevor Raymond Strutt, the Group Chief Operating Officer.	10.0%
Bubbly Brooke – 100% owned by a family trust of Ms. Li Hongmei, Mother-in-law of the Group Chairman Mr. Sun.	16.3%
Peace & Smooth – one of the founders. Of which 50% voting power is held by Mr Nie Kuang and 50% by Mr. Yang Yonggang (a vice president).	11.0%
Rongton – one of the founders. Of which 55% voting power is held by Mr Zhao Xiangti (an executive director of the Group) and 50% by Mr. Yang Yonggang (a vice president).	17.0%
Baring – private equity companies	14.0%
Gold Stand Goal – a financial investor	1.0%
Pinpoint Capital – a financial investor	1.0%
Winford Global – a financial investor	2.1%
Deutsche Bank – a financial investor	2.7%
Public shareholders	25.0%
	100.0%

Use of Proceeds

Net proceeds from the offer are estimated to be HK$2.16 billion *(based on an offer price of HK$6.97, being the mid-point of the indicative price range and assuming the over-allotment option is not exercised)*

	HK$ million
For the construction, equipment purchase, operation and other areas in connection with the existing production facilities and those under development.	1,401.0
For the future business development.	543.9
General working capital.	216.1

Financial Highlights

	Year ended 31st Dec			6 months ended	
	2006	2007	2008	30th Jun 2008	30th Jun 2009
	RMB million	RMB million	RMB million	RMB million	RMB million
Turnover	485.1	783.7	1,411.7	620.0	917.2
Gross profit	228.5	319.6	583.6	268.2	331.1
Operating profit	179.9	252.0	489.9	235.3	278.0
Profit/(loss) attributable to shareholder	**(6.7)***	**177.0**	**430.1**	**200.7**	**232.5**
Gross profit margin	*47.1%*	*40.8%*	*41.3%*	*43.3%*	*36.1%*
Operating profit margin	*37.1%*	*32.2%*	*34.7%*	*37.9%*	*30.3%*
Net profit margin	*-1.4%*	*22.6%*	*30.5%*	*32.4%*	*25.3%*
	31/12/2006	**31/12/2007**	**31/12/2008**	**30/6/2008**	**30/6/2009**
Net debt to shareholders' equity	73.6%	76.0%	79.6%	N/A	80.9%

Remark: (*) the Group reported a fair value loss on convertible loans and preferred shares of RMB78.9 million and a loss of RMB56.2 million on termination of the US20.2 million loan facility and modification of the preferred shares issued to Baring in 2006, pursuant to the Reorganisation before the Global Offering. The preferred shares will be automatically converted to ordinary shares and no preferred shares will be outstanding after the Listing Date.

Strengths/Opportunities

- ✓ The Group is second largest on-site industrial gas supplier in the Mainland with a market share of 22.3%, in terms of revenue in 2008, after Germany's Lingde AG (with a market share of 25.4%). Given the established business scale, the Group is well positioned to compete with rivals for large-scale on-site projects in China.
- ✓ The Group currently operates 20 gas production facilities (19 on-site and 1 merchant). Five (on-site) of which have only commenced operation since March 2009, while their full-period contribution would help boost the Group's growth momentum in the second half.

- ✓ There are 10 on-site and 2 merchant facilities under development, which are scheduled to come on stream from Oct 2009 to Dec 2011. Upon completion, these projects will boost the Group's oxygen and nitrogen installed capacity by 101% and 88%, respectively, fuelling the growth engine in the next couple of years. The facilities under development also include four sizable on-site projects with a coal chemical subsidiary of the China Shenhua Energy Group, which would account for a combined 28% of the Group's total oxygen capacity and 20% of that of nitrogen following the commencement of the 12 facilities under development.
- ✓ Outsourcing accounted for about 42% (by value) of the total industrial gas market in the Mainland in 2008, up from 41% in 2007. There is a growing trend of outsourcing among end users of industrial gases in China, as independent gas suppliers could provide with professional management and reliability at a competitive cost. The market share of outsourcing is expected to grow to 45% by 2010 and 50% by 2015.

Weaknesses/Threats

- × The Group's gross profit margin fell to 36.1% in the first half of 2009 from 43.3% a year earlier, owing to dropping contribution from its merchant operation amid falling industrial gas prices in the spot market on global economic recession. For instance, the average selling price (ASP) of oxygen sold to the Group's merchant customers stood at RMB0.69/Nm^3 in 1H2009, down 22.5% from RMB0.89/Nm^3 in 1H2008. The ASP for nitrogen sold to merchant customers saw a sharper drop during the first half, down from RMB1.18/Nm^3 in 1H2009 to RMB0.68/Nm^3 a year earlier.
- × Electricity accounted for 80%-90% of the Group's total costs. While rising electricity tariff led to growing cost pressure to Yingde, the Group is generally able to pass its utility costs to its on-site customers to keep a more stable profit margin when compared with its merchant business.
- × At top end of the indicative price range, the issue will be priced at a rich valuation of 26x FY09E P/E, higher than the forward P/E of the Mainland's top industrial gas player Linde AG (a Germany-listed company with core operation in Europe) at 16x. Nonetheless, given a stronger growth outlook in China, the premium valuation is justified.

Recommendation: Trading Buy

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