

Analyst: Paul Sham

Main Board Listing – Research

中國金屬再生資源 (控股) 有限公司

China Metal Recycling (Holdings) Limited [Stock Code: 00773]
Sole Global Coordinator, Bookrunner and
Lead Manager

: UBS AG

Joint Sponsors

: UBS AG

: China Merchants Securities (HK) Ltd

Sector : Materials

Business : Recycling scrap metals

Total share offer: *300,000,000 shares
(30.0% of the enlarged share capital)

Public Offer: 30,000,000 shares (10%)

Placing: 270,000,000 shares (90%)

Greenshoe: 45,000,000 shares

**All 300,000,000 shares are New Shares*
Price: HK\$3.98 – HK\$5.18 per share

Market Cap: HK\$3,980 million– HK\$5,180 million

Historical FY08 PER: 13.5x – 17.6x

Adjusted NTA per share: HK\$1.94 – HK\$2.29

Staffing: 475 (as of 3rd June 2009)

HK Public Offer period:

10th June 2009 – 15th June 2009

Receiving bank:

Hnag Seng Bank Limited

The Bank of East Asia, Limited

DBS Bank (Hong Kong) Limited

Share registrar:

Tricor Investor Services Limited

Listing date: 22nd June 2009

Business of China Metal Recycling (CMR)

CMR is the largest scrap metal recycling company in China based on 2008 revenue. The Company purchases scrap steel, scrap copper and other scrap metal from both overseas and domestic suppliers and then separate the scrap into various metal components and produce recycled scrap metal products that meet customers' needs in terms of size, purity and other requirements.

CMR's products are sold to metal manufacturers in China in the production of new crude steel and other non-ferrous metals. These materials, in turn, are used in the production of a wide range of end products, including construction materials, heavy equipment, automobiles, aircraft, ship and household appliances.

The current recycling facilities of CMR are located in Guangdong Province, Jiangsu Province and Hong Kong. The Company is also in the process of establishing new recycling facilities in Tianjin, Zhejiang Province and Jiangsu Province.

Shareholding Structure after Listing

Mr. Chun Chi-wai, <i>an executive Director, the Chairman and CEO of CMR</i>	63.5%
Spinnaker Global Emerging Markets Fund Ltd.	1.3%
Spinnaker Global Opportunity Fund Ltd.	0.8%
Spinnaker Global Strategic Fund Ltd.	1.1%
The ADM Maculus Fund III L.P.	3.3%
Public Investors	30.0%
	100.0%

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,285 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$4.58 each, being the midpoint of the indicative price range).

	HK\$ million
To redeem the entire US\$80.0 million outstanding principal amount of the Senior Notes, plus accrued coupon interest and settle all of the Listco Warrants in cash	781
To expand operations in Ningbo, Zhejiang, Yangzhong and Jiangsu Province	193
To expand operations in Tianjin	129
To expand operations in Guangdong Province	64
To expand operations in Wuhan and Hubei Province	118

Financial Highlights

	Year ended 31 st December		
	2006 HK\$'000	2007 HK\$'000	2008 HK\$'000
Revenue	1,090,338	1,942,400	6,526,594
Gross profit	118,586	241,387	495,060
Attributable profit	46,626	137,691	294,431
Gross margin	10.9%	12.4%	7.6%
Net margin	4.3%	7.1%	4.5%

Revenue Breakdown by business activities (% of Total Revenues)

	Year ended 31 st December					
	2006 HK\$'000	%	2007 HK\$'000	%	2008 HK\$'000	%
Ferrous metals	479,481	44.0%	703,032	36.2%	2,291,541	35.1%
Non-ferrous metals	610,857	56.0%	1,239,368	63.8%	4,235,053	64.9%
Total	1,090,338	100.0%	1,942,400	100.0%	6,526,594	100.0%

Strengths/Opportunities

- ✓ **Favourable PRC policy on recycling industry** Under Steel Policy released in 2005, the government aimed to enhance awareness of environmental protection and improve the utilisation rate of iron ore, which emphasized the importance of recycling in the steel industry. Also, one of the goals set forth in the Eleventh Five-Year Plan of the PRC government is to develop and promote recycling technologies. Therefore, the metal recycling industry would benefit from the government's energy and resource conservation policies, with tax incentives and other support measures expected to be introduced.
- ✓ **Superior inventory management** The average inventory turnover days of CMR improved from 15 days for the six months ended 30 June 2008 to 12 days for the year ended 31 December 2008. Also, approximately 97.1% of CMR's inventory as of 31 December 2008 had been sold to customers by 31 March 2009, suggesting that CMR has established an efficient inventory management system.

- ✓ **Fair valuation** Based on the mid-point of the indicative offering price, the expected P/E multiple of CMR in FY09E is 15.6x. Compared with Nine Dragons Paper (a market leader in recycled paper products), with FY09E PE ratio of 17.5x, valuation of CMR looks reasonable.

Weaknesses/Threats

- × **Repaying debt as the primary goal** Up to 61% of the proceeds would be used to redeem high-interest senior notes (issued in October 2007) with an effective interest rate of 18%. Raising capital to repay debt makes the share offer look unappealing.
- × **Recycling business highly affected by the price of raw materials** The raw materials for CMR's operations are scrap ferrous and scrap non-ferrous metal. Nevertheless, the price of raw materials experienced drastic change in the past years. The average cost per metric ton of scrap metal in 2006, 2007 and 2008 was HK\$3,325, HK\$5,626 and HK\$7,940, respectively. CMR's profit margin could be squeezed if CMR is unable to pass on higher raw material costs to its customers.
- × **High concentration of customers** The 5 largest customers amounted to 97.3%, 99.3% and 73.2% of the Group's total turnover for 2006, 2007 and 2008 while the largest customer represented 60.9%, 39.3%, 30.4% of the Group's turnover for the same periods, respectively. Despite the figure shows improving client mix in 2008, CMR's business could still be significantly impacted if it could not maintain relationship with any one of the top 5 customers.
- × **Inorganic business expansion** CMR generated revenue of HK\$1,090.3 million, HK\$1,942.4 million and HK\$6,526.6 million, respectively, in 2006, 2007 and 2008, representing a CAGR of 144.7%. Nevertheless, CMR's growth story is not driven by organic growth, but by acquisitions. Especially in January 2008, CMR acquired a 70% equity interest of Zhangjiagang Rongli. Therefore, claiming itself as the largest scrap metal recycling company in the PRC based on revenue might give a wrong perception on CMR's successfulness in recycled industry.

Recommendation: Trading buy

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