

Analyst: Paul Sham

Main Board Listing – Research

山東晨鳴紙業集團股份有限公司

Shandong Chenming Paper Holdings Limited [Stock Code: 01812]
Sole Global Coordinator : Guotai Junan Securities (Hong Kong) Limited

Sole Sponsor : Guotai Junan Capital Limited

Joint Bookrunners and Joint Lead Manager : Guotai Junan Securities (Hong Kong) Limited
Macquarie Capital Securities Limited

Sector : Materials

Business : Manufacture and sale of paper products

Total share offer: <u>*355,700,000</u> shares (17.25% of the enlarged share capital) Public Offer: 35,570,000 shares (10%) Placing: 320,130,000 shares (90%) Greenshoe: 53,355,000 shares <i>*All 355,700,000 shares are New Shares</i>	<u>Business of Chenming Paper</u> Established in Dec 1996, Chenming is currently the largest Chinese paper producer in terms of total sales from 2004 to 2007. Its annual production capacity of 3.17 million tons is the 4 th largest in China and 25 th largest in the world. In addition, “Chenming” brand was listed as China’s top paper industry brand in the “Top 500 Chinese Brands” survey in 2006. Chenming focuses on making and selling medium to high-end paper products. The paper products it offers include art paper, light weight coated paper, white paper board, duplex press paper, writing paper, news press paper and paperboard. For most of its paper products, Chenming ranks as the top 3 producer in China. Chenming’s products are sold to customers in the PRC and overseas primarily through the regional sales offices located in major cities in the PRC and overseas sales offices in Japan, South Korea and the subsidiary Chenming HK. Its customers are principally publishing companies and manufacturers of consumer products. As of May 28, 2008, Chenming had a total customer base of over 5,000 companies. Regarding its capital structure, Chenming issued B Shares in 1997 and A Shares in 2000. Both of them are listing in the Shenzhen Stock Exchange.
Price: HK\$9.00 – HK\$11.80 per share Market capitalisation of the H Shares: HK\$3,521.4 million – HK\$4,617.0 million Fully diluted FY07 PER: 18.7x – 24.5x Adjusted NTA per share: RMB5.37 – RMB5.79 or HK\$6.00 – HK\$6.47 Staffing: 16,064 (as of 31 st December 2007)	
HK Public Offer period: 4 th June 2008 – 10 th June 2008 Receiving banks: Bank of China (Hong Kong) Limited ICBC (Asia) Limited The Bank of East Asia, Limited Share registrar: Computershare Hong Kong Investor Services Ltd. Listing date: 18 th June 2008	

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**Shareholding Structure after Listing** (Assuming the over-allotment option is not exercised)

A-Shares held by Shouguang Chenming Holdings – 75.73% owned by Shouguang SASAC*	14.21%
A-Shares held by Directors, Supervisors and senior management of the Company	0.71%
A-Shares held by the public	39.07%
B-Shares held by the public	27.04%
H-Shares to be held by the public – of which 1.72% of the total issued shares were held by NSSF [^]	18.97%
	100.00%

Remark: (*) SASAC - State-owned Assets Supervision and Administration Commission

(^) NSSF- The National Social Security Fund

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$3,052.4 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$9.00 each, being the lowest point of the indicative price range)

	HK\$ million
For the acquisition of land and the construction of pulp production plants of the Zhanjiang Project	1,058.3
For the purchase of various production equipment of the Zhanjiang Project	1,719.4
For general working capital purpose	274.7

Financial Highlights

	Year ended 31 st December		
	2005 RMB millions	2006 RMB millions	2007 RMB millions
Revenue	9,625.8	11,714.0	14,878.9
Gross profit	1,963.3	2,252.3	3,033.3
Attributable profit	640.8	400.6^{##}	994.0
Gross margin	20.4%	19.2%	20.4%
Net margin	6.7%	3.4%	6.7%

^{##} In FY2006, some RMB229 million were recorded as “loss on change in conversion price of convertible loan notes”.

Revenue Breakdown by paper product type (% of Total Revenues)

	Year ended 31 st December					
	2005		2006		2007	
	RMB millions	%	RMB millions	%	RMB millions	%
White paper board	1,205.9	13.5	1,987.5	18.5	2,348.4	17.0
Art paper	2,409.5	26.9	1,884.8	17.5	2,308.7	16.7
Duplex press paper	1,281.5	14.3	1,672.3	15.5	2,069.4	15.0
News press paper	867.7	9.7	1,002.0	9.3	1,979.0	14.3
Light weight coated paper	979.5	10.9	1,795.7	16.7	1,887.4	13.6
Paperboard	778.5	8.7	774.4	7.2	915.8	6.6
Writing paper	403.2	4.5	366.3	3.4	252.9	1.8
Other paper products	1,032.6	11.5	1,279.6	11.9	2,076.2	15.0
Total revenue of paper products	8,958.4	100.0	10,762.6	100.0	13,837.8	100.0

**Strengths/Opportunities**

- ✓ **Vertical integration - Zhanjiang project** The capital raised from the public offering is primarily for the investment in the Zhanjiang project, which is located in Guangdong Province. Upon completion of Zhanjiang project in 2H 2010, Chenming's pulp (the raw material of paper products) self-supply rate is expected to increase significantly from about 70% at present to 100%, which should enable Chenming to achieve cost-saving purpose by reducing the pulp purchase cost from the 3rd parties.
- ✓ **Diversified product mix** Unlike Nine Dragons and Lee & Man, which manufacture primarily 1 or 2 paper types, Chenming has a highly diversified product mix, including 7 major paper products. Its well-balanced product portfolio (none of the paper product accounted for over 20% of the total revenue) helps spread the risk of market downturns in any particular type of paper product.
- ✓ **Low concentration of customers** Sales to the 5 largest customers for each of the 3 years ended 31 Dec, 2007 accounted for only 10.2%, 9.9% and 7.0% of its total revenue, respectively. Such low concentration of customers suggests that Chenming should have a good pricing power on its customers.
- ✓ **Favourable national policy on large players** The fragmented Chinese paper industry, comprising of about 3,500 papermaking enterprises, is going through a consolidation. The newly released Paper Making Industry Development Policy has taken effect from Nov 2007, which aims to improve the industry structure by increasing the concentration ratio of the top 30 producers from 32% to 40% by 2010. Such policy tends to be favourable to the existing large players such as Chenming.
- ✓ **First firm to issue A, B, H shares** Chenming Paper is going to be the first firm that has publicly traded A, B and H shares. The offering price of the Company's H shares (HK\$9.0 – HK\$11.80) is at a discount to its mainland-traded A shares (000488.SZ: RMB15.37 as of June 3, 2008) and is also close to the price of B shares (200488.SZ: HK\$8.40 as of June 3 2008), making them a reasonable proposition for investors. Unless there is a big slump in the stock market before the listing date, we believe the shares will probably stay above the offering price.

Weaknesses/Threats

- × **Comparatively low profit margin** Despite the gross margin of Chenming (FY07: 20.4%) is comparable to those of Nine Dragons (FY07: 25.7%) and Lee & Man (FY07: 26.38%), its FY07 net margin of 6.7% is much lower than Nine Dragons' 18.2% and Lee & Man's 18.4%. Its underperformed bottom line can be attributed to its relatively high distribution expenses, administrative expenses and finance costs which accounted for 13.4% of its total revenue in 2007. In contrast, the above costs only contributed 6.9% and 9.0% of Nine Dragons' and Lee & Man's FY07 total revenue.

Recommendation: Subscribe



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