

**Analyst: Sabina Cheng**

## Main Board Listing – Research

Dongyue Group Limited [Stock Code:0189] 東岳集團有限公司
**Sole Global Coordinator, Sponsor,  
Bookrunner, and Lead Manager**

: Citigroup Global Market Asia Limited

**Sector** : Chemical

**Business** : China's leading fluorochemicals producer, moving into silicone

<b>Total share offer:</b> <u>520,000,000</u> shares <b>(25% of the enlarged share capital)</b>  <b>Public Offer:</b> 52,000,000 shares (10%) <b>Placing:</b> 468,000,000 shares (90%) <b>Greenshoe:</b> 78,000,000 shares	<b><u>Business of Dongyue</u></b>  Established in 1987, Dongyue is one of the largest refrigerants and polytetrafluoroethylene (PTFE) producers in the world in terms of production capacity based on research by SRI consulting. It is also the largest refrigerants and PTFE producer in China in terms of sales volume with market share of about 26% and 28% respectively. Nearly two-third of the Group's total sales were domestic sales. Exports to the developing and developed countries accounted for 28.5% and 8.5% of the turnovers respectively.  Dongyue is the largest producer in fluorocarbons chemicals and fluoropolymers. Fluorocarbons chemicals like HFC-134 is mainly used in automobile air conditioners and HCFC-22 is mainly used in refrigerators and air conditioners and as a feedstock for fluoropolymers. Fluoropolymers products include PTFE and HFP, which are widely used in the construction, electronics, automobile and aerospace industries.  Dongyue has established and in the process of expanding its silicone product line which silicone products are widely used in consumer products, construction materials and manufacturing. Examples are silicone sealants, silicone fluids, silicone resins are widely used in construction, shampoos and paints respectively.
<b>Price:</b> HK\$2.05 - HK\$2.63 per share  <b>Market Cap:</b> HK\$4,264 million– HK\$5,470.4 million  <b>Pro forma FY2007E PER:</b> 20.3X – 26.0X  <b>Adjusted NTA per share:</b> HK\$0.83 – HK\$0.97  <b>Staffing:</b> 3,451 (as of 30 <sup>th</sup> June 2007)	
<b>HK Public Offer period:</b> 26 <sup>th</sup> November 2007 – 29 <sup>th</sup> November 2007  <b>Receiving banks:</b> Bank of China (HK) Limited Bank of Communications Standard Chartered Bank  <b>Principal share registrar &amp; transfer office:</b> Butterfield Fund Services (Cayman) Limited  <b>HK branch share registrar &amp; transfer office:</b> Computershare HK Investor Services Limited  <b>Listing date:</b> 10 <sup>th</sup> December 2007	

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

Macrolink International (A wholly owned subsidiary of Macrolink, in which Mr Fu Kwan – an executive director of Dongyue- owns a 40% of interest)	31.67%
Dongyue Team (100% owned by Mr Zhang Jianhong)	7.21%
Dongyue Wealth (100% owned by Mr Liu Chuanqi, an executive director of Dongyue)	3.78%
Dongyue Initiator (100% owned by Mr Cui Tongzheng, an executive director of Dongyue)	6.44%
Baring Private Equity Asia III Holding (9A) Limited	17.26%
IFC	8.64%
Public Investors	25%
	<b>100.00%</b>

**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$1,137.2 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$2.34 each, being the midpoint of the indicative price range)

	HK\$ million
To finance the expansion of production capacities of the existing products and diversification into new product lines (40% for the refrigerants business; 15% for fluoropolymers business and 45% for liquid alkali businesses)	454.9
To finance the construction plans for the silicone products	454.9
To upgrade equipment and purchase of advanced production equipment and facilities at the Group's Industrial Park	170.5
To provide funding for working capital and other general corporate purposes	56.9

**Financial Highlights**

	Year ended 31 <sup>st</sup> December			Six months ended June 30	
	2004	2005	2006	2006	2007
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Sales	1,183,987	1,684,761	2,005,932	936,392	1,121,114
Gross profit	232,455	371,865	428,449	203,846	249,292
Operating profit	93,595	210,863	219,240	104,841	134,626
Attributable profit	42,752	149,949	141,257	65,371	73,768
Gross margin	19.6%	22.1%	21.4%	21.8%	22.2%
Operating margin	7.9%	12.5%	10.9%	11.2%	12.0%
Net margin	3.6%	8.9%	7.0%	7.0%	6.6%

**Group's revenue by product type**

	Year ended 31 <sup>st</sup> December						For the six months ended June 30			
	2004		2005		2006		2006		2007	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
Refrigerants	792,340	67	1,005,564	60	1,083,103	54	587,219	63	579,696	52
Fluoropolymers	265,750	22	387,691	23	490,987	24	204,869	22	263,294	23
Other Products (dichloromethane and liquid alkali)	125,897	11	291,506	17	431,842	22	144,304	15	278,124	25
Total	1,183,987	100	1,684,761	100	2,005,932	100	936,392	100	1,121,114	100



## **Strengths/Opportunities**

- ✓ **Enhancing upstream proximity** Instead of fully relying on external sources for raw materials of fluorspar (which accounts for about 10% of the total raw materials used), the Group has established a long-term investment co-operation agreement with the government of Chifeng, Inner Mongolia to utilize the fluorspar resources in Chifeng starting this year. This should be good news for the Group, as over the past few years, the price of fluorspar has been on an upward trend due to increasing market demand and various measures that restrict the mining and export of fluorspar by some key fluorspar production countries.
- ✓ **High entry barrier** The fluorochemical industry should have high entry barrier given the requirement for specific technical know-how, business and operational management know-how, capital investment and the ability to source a secured supply of upstream raw materials.
- ✓ **Good business strategies for sustainable growth** The Group will expand its capacities to meet growing demand, increasing sales to high growth markets, enhancing operational efficiency and diversifying into new product range such as silicone monomers and intermediates as well as PVC which is a widely used thermoplastic polymer. By the end of 2007, the Group will be able to achieve annual production capacity of 60,000 tonnes each for silicone and PVC. It will further be expanded to 160,000 tonnes and 120,000 respectively after completion of second phase next year.

## **Weaknesses/Threats**

- × **Policy risks:** Montreal Protocol requires the developed and developing countries to terminate using HCFC-22 as refrigerants by 2020 and 2030 respectively. Being required to comply with such requirement, Dongyue with production in China, who is a member of such protocol is forced to refocus the business strategies on (i) increasing its internal consumption of HCFC-22 to produce fluoropolymers, (ii) export of HCFC-22 to developing countries instead, and (iii) export of HCFC-22 to developed countries for use as raw materials to manufacture fluoropolymers to alleviate the drop in future sale of its key product HCFC-22 in both mainland and overseas. Any further amendments on such protocol could jeopardize the effectiveness of such refocused production strategies and thus the business performance of the Group.
- × **Financial risks:** The fluorochemical industry is capital intensive. For part of the Group's future growth strategy, it has planned CAPEX of about RMB1,185 million and RMB1,620 million in 2007 and 2008 respectively. These are supposed to be funded by future cash generated from operations, bank borrowings and the net proceeds from the Global Offering. Yet the estimated amounts of CAPEX may subject to change by the many factors like market conditions. Any further additionally funding from debts could harm the Group's balance sheets as the forecasted 2007 and 2008 net gearing has already up to a high level of 108% and 83.4% respectively.
- × **Market risks:** Owing to the intensified market competition and unstable cost of raw materials, the Group's key products prices in respect of HCFC-22 and PTFE dropped 21% and 7% respectively between 2004 and 1H2007. This may signal that the pricing power of some of the Group's products has been weakening.

**Recommendation:    Trading Buy**



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