

Analyst: Kelvin Li

## Main Board H-share Listing – Research

中國中鐵股份有限公司

China Railway Group Limited [Stock Code: 0390]

<b>Joint Global Coordinators</b>	:	BOCI	JPMorgan	UBS
<b>Joint Bookrunners, Joint Lead Managers and Joint Sponsors</b>	:	BOCI	JPMorgan	UBS ABN AMRO Rothschild

**Sector** : Capital goods

**Business** : Construction of railways, highways and related services, property development and mining

**Total share offer:** 3,326,000,000 H shares  
(15.99% of the enlarged share capital)

*Remark: 332.6 million non-tradable Domestic Shares will be converted into H shares and held by National Council for Social Security Fund (NSSF) of the PRC. As a result, the total issued and converted H shares will account for 17.59% of the enlarged share capital upon completion of the Global Offering, assuming the Over-allotment Option was not exercised.*

**Public Offer:** 332,600,000 H shares (10%)

**Placing:** 2,993,400,000 H shares (90%)

**Greenshoe:** 498,900,000 H shares

**Price:** HK\$5.03 – HK\$5.78 per H share

**H-share Market Cap:** HK\$18.4 bln - HK\$21.1 bln

**Pro forma fully diluted FY07E EPS:** RMB0.115  
(assuming the A-share offering is completed and 4.675 billion A shares are newly issued)

**Pro forma fully diluted FY07E PER:** 41.9x -48.2x

**Adjusted NTA per H share:** RMB1.8 – RMB2.1  
(assuming the A-share offering is completed and 4.675 billion A shares are newly issued at RMB4.00-RMB4.80)

**Staffing:** 272,050 (as of 30<sup>th</sup> June 2007)

**HK Public Offer period:**  
23<sup>rd</sup> November 2007 - 28<sup>th</sup> November 2007 noon

**Receiving bank:** Bank of China (Hong Kong)  
Bank of Communications, HK branch  
ICBC (Asia)  
The Bank of East Asia  
Standard Chartered Bank

**Share registrar:** Computershare Hong Kong  
Investor Services Limited

**Listing date:** 7<sup>th</sup> December 2007

### Business of China Railway

China Railway, one of the *Fortune Global 500* companies, is the largest integrated construction group in the Mainland as well as in Asia, and the third largest construction contractor in the world, in terms of total contracting revenue in 2006.

The Group offers a full range of construction-related services, including infrastructure construction, survey, design & consulting services, and engineering equipment & component manufacturing. Leveraging on the full service set, China Railway could provide its customers with integrated one-stop solutions and compete effectively in large-scale and complex projects.

China Railway has been enjoying a leading position in the railway construction industry in the Mainland since 1950's. It is also one of market leaders in design and construction of bridges, tunnels and electrified railways. The Group's business can be categorized into five segments, namely infrastructure construction, survey, design & consulting services, engineering equipment & component manufacturing, property development and other business.

The Beijing-Kowloon Railway (京九鐵路), the Qinghai-Tibet Railway, Golmud to Lhasa Section (青藏鐵路格爾木至拉薩段), the Wuhan-Guangzhou Passenger Railway Line (武廣客運專線) – the longest passenger railway line in the Mainland, and Wuhan Tianzhezhou Yangtze River Bridge (武漢天興洲公鐵兩用長江大橋) are among the most well-known projects completed or being constructed by the Group.

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

China Railway Engineering Corporation, a state-owned enterprise controlled by the State-Owned Assets Supervision and Administration Commission (SASAC)	59.94%
A share public investors	22.47%
H share public investors*	15.99%
H shares held by NSSF	1.60%
	<u>100.0%</u>

Remark: (\*) A group of corporate investors has agreed to subscribe for an aggregate HK\$3,180 million of the H-share offering. Subscriptions of the corporate investors include HK\$780 million for China Investment Corporation and HK\$300 million each for China Life Franklin Asset Management Co., Ltd., Government of Singapore Investment Corporation, Grahamstowe Investments (owned by NBA Houston Rockets owner Mr. Leslie Lee Alexander), Honeybush Limited (controlled by Mr. Kuok Hock Nien and/or interests associated with him), Rupert International (owned by SHKP's Kwok family), Fenbourne Investments (controlled by Wheelock's Mr. Woo Kwong Ching), Kesco Investment (owned by Dr. Lee Shau Kee's Shau Kee Financial Enterprises) and the OZ Group.

**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$17.253 billion (assuming an offer price of HK\$5.41, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For equipment purchase	11,387
For investment in overseas mining operations	2,933
For repayment of bank loans	1,208
For working capital	1,725

**Financial Highlights**

	Year ended 31 <sup>st</sup> Dec			6 months ended	
	2004	2005	2006	30 <sup>th</sup> Jun 2006	30 <sup>th</sup> Jun 2007
	RMB million	RMB million	RMB million	RMB million	RMB million
Revenue	86,829	111,423	153,568	60,374	72,489
Gross profit	7,207	9,192	11,921	5,123	5,537
Operating profit	845	1,619	3,682	1,219	1,439
<b>Profit attributable to shareholders</b>	<b>463</b>	<b>171</b>	<b>2,046</b>	<b>483</b>	<b>643</b>
Gross profit margin	8.30%	8.25%	7.76%	8.49%	7.64%
Operating profit margin	0.97%	1.45%	2.40%	2.02%	1.99%
Net profit margin	0.53%	0.15%	1.33%	0.80%	0.89%
	<b>31/12/2004</b>	<b>31/12/2005</b>	<b>31/12/2006</b>	<b>30/6/2006</b>	<b>30/6/2007</b>
Net debt to Equity	28.16%	33.83%	42.08%	N/A	189.74%

**Revenue breakdown in terms of business segments**

(RMB billion)	2004	%	2005	%	2006	%	1H06	%	1H07	%
Infrastructure construction	77.2	89%	99.2	89%	140.4	91%	54.4	90%	67.7	93%
Survey, design & consulting services	2.8	3%	3.5	3%	4.1	3%	1.6	3%	1.5	2%
Engineering equipment & component manufacturing	3.0	3%	3.8	3%	4.1	3%	2.0	3%	2.2	3%
Property development	0.9	1%	1.6	2%	1.9	1%	0.9	2%	1.4	2%
Other businesses	4.0	5%	4.7	4%	6.3	4%	2.5	4%	4.0	6%
Inter-segment eliminations	(1.1)	(1%)	(1.4)	(1%)	(3.2)	(2%)	(1.0)	(2%)	(4.3)	(6%)
<b>Total</b>	<b>86.8</b>	<b>100%</b>	<b>111.4</b>	<b>100%</b>	<b>153.6</b>	<b>100%</b>	<b>60.4</b>	<b>100%</b>	<b>72.5</b>	<b>100%</b>

**Operating profit breakdown in terms of business segments**

(RMB million)	2004	%	2005	%	2006	%	1H06	%	1H07	%
Infrastructure construction	157	18%	566	35%	2,227	60%	607	50%	715	49%
Survey, design & consulting services	169	20%	132	8%	351	10%	115	9%	67	5%
Engineering equipment & component manufacturing	379	45%	432	27%	445	12%	168	14%	67	5%
Property development	90	11%	344	21%	426	12%	257	21%	285	20%
Other businesses	5	1%	87	5%	181	5%	182	15%	116	8%
Inter-segment eliminations and unallocated items	45	5%	58	4%	52	1%	(110)	-9%	189	13%
<b>Total</b>	<b>845</b>	<b>100%</b>	<b>1,619</b>	<b>100%</b>	<b>3,682</b>	<b>100%</b>	<b>1,219</b>	<b>100%</b>	<b>1,439</b>	<b>100%</b>

**Strengths/Opportunities**

- ✓ China Railway is one of the key infrastructure market players in the Mainland. Therefore, it is considered as a close proxy to the fast-growing fixed-asset investments in China.
- ✓ The Group exhibited a track record of strong revenue growth. During FY04-FY06, the Group's backlog contract value grew at a CAGR of 51.6%, while new contract value expanded at a CAGR of 22.7%.
- ✓ In order to boost the efficiency and scale of the Mainland's national railway system, the Chinese government has called for, in its Eleventh Five-Year Plan, a total investment of about RMB1.25 trillion to develop the country's railway network in 2006-2010, up nearly three times from the corresponding amount in the Tenth Five-Year Plan (2001-2005). Such booming investment in railway network would provide the Group with enormous business opportunities ahead. Besides, as the largest PRC railway construction group with strong expertise and market dominance, China Railway is well positioned in winning new railway building contracts. Meanwhile, thanks to the robust railway investment, railway construction has become the Group's core revenue driver. For FY06 and 1H07, revenue from railway construction accounted for about 40% of the Group's total (before inter-segment eliminations), up from 32%-33% in FY04 and FY05. In terms of profit contribution, railway construction accounted for more than one-third of the Group's gross profit over the last couple of years.
- ✓ In addition to railway network, the Chinese government also called for upgrade and extension of the Mainland's road transportation system. The State Council announced the "7-9-18 Expressway Network Plan" in 2004 and has estimated a budget of RMB2.0 trillion through 2020, with about RMB140 billion to be spent per year until 2010 and RMB100 billion a year thereafter.
- ✓ Besides infrastructure construction and related services, China Railway is also engaged in property development and mining, which helps diversify its business portfolio and enhance profit margin. However, one should note that there is little synergy from its mining segment, as two of three mines the Group acquired are located in DR Congo in Africa.
- ✓ China Railway management targets a dividend payout of no less than 25% in FY08 and FY09.
- ✓ Given the mega size and dual-listing status, China Railway is expected to join major stock indexes soon after its listing.

**Weaknesses/Threats**

- × Competition may rise in the Mainland railway construction industry, as other infrastructure groups are planning to take a footstep in the fast-growing sector.
- × China Railway's net profit margin (1.33% in FY06) was low when compared to sector peer CCCC (HKEx: 1800) (2.78% in FY06). It even fell further during the first half of 2007, while CCCC saw its margin nearly doubled y-o-y in 1H07. To boost its profit margins, the Group plans to further explore the overseas market, participate in more BOT (Build, Operate & Transfer) projects and strengthen cost control.

**Recommendation:     Subscribe**

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