

Analyst: Kelvin Li

Main Board H-share Listing - Research

上海集優機械股份有限公司

Shanghai Prime Machinery Company Limited [Stock Code: 2345]

Sole Global Coordinator, Sole Bookrunner, : Credit Suisse (Hong Kong) Limited
Sole Lead Manager and Sole Sponsor

Sector : Capital goods

Business : Manufacture of various industrial equipment

<p>Total share offer: <u>600,562,000</u> H shares (44.545% of the enlarged share capital)</p> <p>Public Offer: 60,058,000 H shares (10%) Placing: 540,504,000 H shares (90%)</p> <p>Greenshoe: 90,084,000 H shares</p>	<p><u>Business of Shanghai Prime Machinery (PMC)</u></p> <p>PMC is a precision parts, components and accessories manufacturing platform of parent Shanghai Electric Corporation, one of the leading industrial conglomerate in the PRC, while the products are used in a wide range of industries.</p> <p>PMC designs, manufactures and sells four key products and provides related services in the mechanical parts and components industry. The four key products are turbine blades, bearings, cutting tools and electric motors. PMC is a leading manufacturer of turbine blades for use in power station turbines, which requires high level of technical sophistication. PMC's bearings and cutting tools products are used in various industries, while electric motors are mainly used in the equipment of heavy industries.</p> <p>PMC is also engaged in the production of carbon products, a consumable component in electric motors, via its 30%-held joint venture, Morgan Carbon, and fasteners (bolts, nuts, screws and nut collars) business via its wholly owned subsidiary, Biaowu Fasteners.</p>
<p>Price: HK\$1.70 - HK\$2.10 per H share Market Cap.: HK\$2,292 million – HK\$2,831 million</p> <p>FY2006E P/E: 10.52x – 13.00x (pro-forma)</p> <p>Adjusted NTA per share: HK\$1.21 – HK\$1.38</p> <p>Staffing: 4,275 (as of 31st December 2005)</p>	
<p>HK Public Offer period: 13th April 2006 – 20th April 2006 noon</p> <p>Receiving bank: HSBC, ICBC (Asia)</p> <p>Share registrar: Computershare Hong Kong Investor Services Limited</p> <p>Listing date: 27th April 2006</p>	

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

Shanghai Electric Corporation*	51.000%
Chinese National Social Security Fund	4.455%
	<u>55.455%</u>

Remark: (*) Shanghai Electric Corporation is also the parent company of the HK-listed Shanghai Electric Group Company (HKEx: 2727).

Remark:

Sponsored by Credit Suisse, Shanghai Electric Group Company (2727) raised some HK\$4.5 billion through its listing (28th April 2005) at an IPO price of HK\$1.76 each; current price is trading at around HK\$2.9 each.

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1.05 billion.

(Assuming issue price of HK\$1.90, being the mid-point of the indicative price range, and the over-allotment option not exercised.)

	HK\$ million
For technology upgrade for high precision turbine manufacturing facilities and manufacturing technology upgrade for large turbine blades for ultra super-critical turbines and nuclear-powered half speed turbines	271
For investments in technology upgrade for manufacturing facilities of numerically controlled and superhard carbide and PCD cutting tools	165
For investments in technology upgrade for manufacturing facilities for a full range of bearings	358
For reform and upgrade of logistics system geared towards international trade	155
For reform and upgrade of management and control systems	39
For working capital	Remaining balance

Financial Highlights

	Year ended 31 st December		
	2003 RMB '000	2004 RMB '000	2005 RMB '000
Revenue	625,596	850,942	1,425,348
Gross profit	148,687	219,070	365,540
Operating profit	45,077	96,580	209,622
Attributable profit to equity-holders	33,110	63,730	134,845
Basic EPS	RMB0.0443	RMB0.0852	RMB0.1804
	RMB million	RMB million	RMB million
Owners' Equity	177,236	253,077	743,868

Strengths/Opportunities

- ✓ PMC's products are used in a wide range of industries in the Mainland, while robust economic growth in the Chinese economy should help support the demand for its products in coming years.
- ✓ To be priced at 10.5x-13.0x FY2006E earnings, valuation of PMC is not demanding when compared with other industrial machinery manufacturers like sister company Shanghai Electric (HKEx: 2727)'s 17.5x FY2006E P/E and Weichai Power (HKEx: 2338)'s 14x FY2006E P/E.

Weaknesses/Threats

- × PMC plans to use the proceeds raised from the share offering to upgrade its manufacturing facilities, in order to expand its business into products with higher margins. However, as PMC's products are widely applied across various industries, where market competition is significant, room for further improvement in the Group's profit margin should be quite limited.
- × PMC's turbine blade business accounted for more than 50% of the Group's total operating profit in 2005. For the business segment, the client base was highly concentrated, with revenue from the top five customers accounting for about 87% of the segment's total. Any failure in maintaining business relationship with these clients may have a material impact on PMC. Besides, as the Group's turbine blade products are used extensively in power station turbines, a possible over-capacity in the power sector in the Mainland may lead to a slowdown in product demand of the segment.

Recommendation: Trading Buy

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