

Analyst: Sam Ho

Main Board H-share Listing- Research

中國航空科技工業股份有限公司

AviChina Industry & Technology Company Limited [Stock Code: 2357]

Joint Global Coordinator and Joint Bookrunners : ING BOCI

Joint Sponsors and Joint Lead Managers : BOCI Asia Limited ING

Sector : Automobile & aviation

Business : Production and sale of vehicles and civilian aircraft in China

Total share offer: 1,599,810,000 shares
(35% of the enlarged share capital)

Placement: 1,439,826,000 shares (90%)
145,440,000 sale shares
1,294,386,000 new shares

IPO: 159,984,000 shares (10%)

Greenshoe: 239,970,000 shares

Price: HK\$0.95-HK\$1.21 per share
H-share Market cap. :
HK\$1,519.8 million-HK\$1,935.8 million

Prospective FY2003 P/E:
10.2x-13.0x (fully diluted)

NAV per share: HK\$0.84

Staffing: 34,904

Book opens: 13th October 2003
Book closes: 24th October 2003

IPO opens: 21st October 2003
IPO closes: 24th October 2003

Share registrar: Computershare Hong Kong
Investor Services Limited

Receiving bank: Bank of China (Hong Kong)

Listing date: 30th October 2003

Business of AviChina

The Company is principally engaged in the production and sale of vehicles and civilian aircraft in China. The auto division concentrates in minivans, mini-trucks, economy cars, engines and other auto components, while the aviation division's products include helicopters, regional jets, trainers, general-purpose aeroplanes and aviation components.

The Company was the largest mini-sized vehicle maker in terms of sales volume in 2002 (some 40% market share). It develops, manufactures and sells mini-sized vehicles using its own brands (*Songhuajiang* and *Changhe*) and economy sedans using own brands (*Beidouxing*, *Saima*, *Baili* and *Lobo*). Its vehicle and vehicle-engine production facilities are located in the Heilongjiang, Jiangxi and Anhui provinces. The Company has an extensive sales and service network throughout 30 provinces, autonomous regions and municipalities in China through 4 direct sales centres and some 790 distributors. Moreover, it had established a joint venture with Suzuki to produce new models of vehicles as well as a joint venture with Mitsubishi to produce 1.3-litre and 1.6-litre vehicle engines.

Meanwhile, the Company is 1 of the 2 leading civil-aeroplane manufacturers and also the only helicopter manufacturer capable of large-scale production in China. Its aviation production facilities are located in Heilongjiang and Jiangxi provinces. In December 2002, the Company set up a joint venture with Brazil's Embraer to produce the ERJ-145 series 30-50 seats regional jets and provide relevant sales and after-sale services in China.

Major Shareholders after Listing

(Assuming the over-allotment option is not exercised)

China Aviation Industry Corporation II (AVIC II)	62.18%
China Huarong Asset Management Corporation	2.18%
China Cinda Asset Management Corporation	0.32%
China Orient Asset Management Corporation	0.32%
	<u>65.00%</u>

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,496 million (Based on the mid-point of the price range of HK\$1.08 each and assuming the over-allotment option is not exercised)

	HK\$ million
To fund the expansion of its production capacities for vehicles and vehicle engines	568
To improve and upgrade its helicopter products as well as develop new models	284
To upgrade and modify its trainers, develop and manufacture of advanced trainers as well as improve and upgrade general-purpose aeroplanes	194
To fund the development of regional jets	194
To establish new R&D centres for vehicles and aviation products	194
To serve as general working capital as well as for marketing and repayment of loans	Balance

Financial Highlights

	6 months ended 30 th June 2003 RMB million	2002 RMB million	Year ended 31 st December 2001 RMB million	2000 RMB million
Revenue				
<i>Automobile</i>				
<i>Mini-sized vehicles</i>	3,237.0	7,210.8	6,196.2	5,628.1
<i>Economy sedans</i>	1,996.6	1,809.2	244.5	11.6
<i>Auto components</i>	537.1	398.4	305.1	317.9
<i>Aviation</i>				
<i>Helicopters</i>	324.8	826.3	601.7	366.1
<i>Trainers</i>	132.1	271.5	462.3	276.7
<i>General-purpose aeroplanes</i>	3.5	26.3	78.5	76.6
<i>Aviation components</i>	219.5	663.2	701.8	585.4
<i>Others</i>	<u>52.3</u>	<u>103.7</u>	<u>77.1</u>	<u>85.6</u>
	<u>6,502.9</u>	<u>11,309.4</u>	<u>8,667.2</u>	<u>7,348.0</u>
Operating profit	<u>488.8</u>	<u>843.4</u>	<u>666.7</u>	<u>572.9</u>
Net profit	<u>201.6</u>	<u>396.7</u>	<u>336.5</u>	<u>243.8</u>
Dividend	74.8	216.5	198.2	145.6

Breakdown of Business Segments by Percentage of Total Turnover

	6 months ended 30 th June 2003	2002	Year ended 31 st December 2001	2000
<i>Automobile</i>				
<i>Mini-sized vehicles</i>	49.8%	63.8%	71.5%	76.6%
<i>Economy sedans</i>	30.7%	16.0%	2.8%	0.1%
<i>Auto components</i>	8.3%	3.5%	3.5%	4.3%
<i>Aviation</i>				
<i>Helicopters</i>	5.0%	7.3%	6.9%	5.0%
<i>Trainers</i>	2.0%	2.4%	5.3%	3.8%
<i>General-purpose aeroplanes</i>	0.0%	0.2%	1.0%	1.0%
<i>Aviation components</i>	3.4%	5.9%	8.1%	8.0%
<i>Others</i>	<u>0.8%</u>	<u>0.9%</u>	<u>0.9%</u>	<u>1.2%</u>
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Summary of operational data

	6 months ended 30 th June 2003 (Units)	2002 (Units)	Year ended 31 st December 2001 (Units)	2000 (Units)
Automobile				
Mini-sized vehicles	116,322	286,207	240,110	210,605
Economy sedans	38,075	33,832	5,042	300
Auto components	37,372	58,870	37,170	36,831
Aviation				
Helicopters	9	28	18	13
Trainers	10	19	34	19
General-purpose aeroplanes	2	2	5	5

Strengths

- ✓ The mini-sized-vehicle sector has already been consolidating and 4 key players, namely AviChina (40% market share), Changan Automobile (30%), SAIC-GM-Wuling (19%) and First Automotive (10%), accounted for about 99% of total mini-sized-vehicle market share in China in 2002. The oligopoly market structure means the key players are able to exert collective control over supply and market prices, helping fence off competition from new entrants.
- ✓ The new auto-financing regulations soon to be issued by the central government should benefit the whole auto sector in China, especially the segment of mini-vehicle and economy sedans, which are priced under RMB100,000 each. Since the target customers of the Company's auto products are mass populations, which are usually not financially sound, the coming relaxed auto-financings available should help stimulate their purchases.
- ✓ According to forecasts made by Bombardier, demand of regional jets in China will reach 600 units over the next 20 years, accounting for 1/3 of the total demand in Asia. In 2001, the CAAC decided in its 10th 5-year plan to adopt the "hub-and-spoke" system to improve the efficiency and profitability of the aviation sector. This should be beneficial to regional-jet producers, as airlines will need these 30-to-90-seat planes for feeder services between hubs and small-and medium-sized cities. So far, the Company, through its 39%-owned joint venture with Embraer, has signed a preliminary sales contract with domestic airlines to deliver 8 regional jets by 2004. Regional-jet operation is expected to be the new growth driver for the Company.
- ✓ Helicopter demand is expected to grow substantially as fewer than 80 helicopters are currently operated for general use in China, representing 0.06 helicopter per million people, far less than the world average of 3.9 helicopters per million people. In addition, demand for helicopters will get a boost upon the opening of low altitude airspace (below a height of 600 metres). AviChina should be the major beneficiary for being the only helicopter producer that is capable of carrying out large-scale production in China.
- ✓ AviChina has formed strategic alliances with a number of renowned overseas companies in the aviation (such as Eurocopter, Embraer, Sikorsky) and automobile (such as Suzuki, Pininfarina and Mitsubishi) industries. These partnerships provide chances for the transfer of skills and enhancement in quality standards of the Company's products.
- ✓ Priced between HK\$0.95 and HK\$1.21, AviChina is valued at a FY2003E P/E of 10.2x-13x, which is undemanding when compared with mainland auto counters -Denway Motors' (stock code: 0203) FY2003E P/E of 14.3x, Brilliance China (stock code: 1114)'s FY2003E P/E of 13.8x and Qingling Motors' (stock code: 1122) FY2003E P/E of 17.5x- as well as global aviation stocks- Bombardier's FY2003E P/E of 23x, Embraer's FY2003E P/E of 7x and SAAB's FY2003E P/E of 14x.

Weaknesses

- × Competition in the auto sector should increase after 2006, as tariffs on auto imports would be reduced to 25% from the current 70%-100% and import quotas abolished at that time, following the WTO requirements. However, this should impact the high-end, luxury car segment more, as the low-end, economy cars are not the key products for foreign large carmakers.
- × The Company's aviation operations depended heavily on AVIC II, its parent company, relating to provision of certain services and products. In 2002, 3 of the company's 5 largest customers and all of its 5 largest suppliers in the aviation operations were AVIC II group members. However, AVIC II has agreed not to engage in businesses that could directly compete with AviChina.
- × The Company's aviation segment relies heavily on mainland government orders, accounting for over 50% of aviation sales in 2000-2002. Any adverse changes in order flow from government authorities may affect the segment's performance and the Company's profitability.

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