

**BEA securities**

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HONG KONG RESEARCH**20th February 2006**

Analyst: Stanley Lau

Main Board Listing – Research

玖龍紙業(控股)有限公司

Nine Dragons Paper (Holdings) Limited [Stock Code: 2689]

Joint Global Coordinators and Joint Sponsors : BNP Paribas Peregrine Capital Limited
Merrill Lynch Far East Limited

Joint Bookrunners and Joint Lead Managers : BNP Paribas Peregrine Capital Limited
BOCI Asia Limited
Merrill Lynch Far East Limited

Sector : Materials**Business** : Manufacturer of containerboard products

<p>Total share offer: <u>1,000,000,000</u> shares (25% of the enlarged share capital)</p> <p>Public Offer: 100,000,000 shares (10%)</p> <p>Placing: 900,000,000 shares (90%)</p> <p>Greenshoe: 150,000,000 shares (15%)</p>	<p><u>Business of Nine Dragons</u></p> <p>The Group is the largest manufacturer of containerboard products in China, in terms of production capacity as of 31st December 2004. The Group produces primarily linerboard, including kraftlinerboard, testlinerboard and white top linerboard, high performance corrugating medium and coated duplex board with grey back. The Group also produces unbleached kraft pulp.</p> <p>As of 15th February 2006, the Group operates ten paper machines with an annual production capacity of 3.3 million tonnes. The Group's paper machines are located in three factories in China, two of which are located in Dongguan, Guangdong province, and one in Taicang, Jiangsu province. The Group has integrated manufacturing operations supported by its own coal-fired power plants, water treatment systems, shipping piers and other transportation infrastructure.</p> <p>The Group has achieved growth in production capacity, sales and net profit at a compounded annual growth rate (CAGR) of 67.3%, 46.6% and 65.7%, respectively, from FY2003 to FY2005.</p>
<p>Price: HK\$2.85 – HK\$3.40 per share</p> <p>Market Cap.: HK\$11.40 billion – HK\$13.60 billion</p> <p>Pro Forma FY2006 P/E: 11.4x – 13.6x</p> <p>Adjusted NTA per share: HK\$1.25 – HK\$1.38</p> <p>Staffing: 5,389</p>	
<p>HK Public Offer period: 20th February 2006 – 23rd February 2006</p> <p>Receiving bank: Bank of China (Hong Kong), Standard Chartered Bank</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 3rd March 2006</p>	

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

Best Result Holdings (BVI) ⁽¹⁾	74.7%
Max Dragon Profits (BVI) ⁽²⁾	0.3%
	75.0%

⁽¹⁾ 37.1% held by Ms. Cheung Yan, Chairman of the Group, as the trustee and HSBC Bank USA as the administrative trustee of YC 2006 QuickGRAT, 37.1% by Ms. Cheung and Mr. Liu Ming Chung, Deputy Chairman of the Group, as the trustees and the special trustees and Bank of The West as the trustee of MCL Living Trust, and 25.8% by BNP Paribas Jersey Trust as the trustee of The Zhang Family Trust and The Golden Nest Trust.

⁽²⁾ 100% held by Ms. Chang Siu Hon, sister of Ms. Cheung.

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$2,934 million.

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$3.125 each, being the mid-point of the indicative price range)

	HK\$ million
To fund capital expenditures on paper machines	1,614
To repay bank borrowings	1,027
Working capital and other general corporate purposes	293

Financial Highlights

	Year ended 30 th June			3 months ended
	2003	2004	2005	30 th September 2005
	RMB million	RMB million	RMB million	RMB million
Sales	2,244.8	2,653.5	4,825.4	1,847.8
Gross profit	290.5	547.8	760.5	379.6
Operating profit	203.5	425.6	558.1	353.3
Net profit	110.6	281.4	303.7	242.1

Strengths/Opportunities

- ✓ China's role as a global manufacturing and export centre has generated a significant amount of demand for containerboard products for use as packaging and shipping materials. China's containerboard consumption increased from 13.0 million tonnes in 2002 to 18.2 million tonnes in 2004, or at a CAGR of 18.3%. Despite significant growth over the past years, China's per capita containerboard consumption remains substantially lower than that of developed countries.
- ✓ The Group has an established brand name in the domestic market and is the market leader in terms of quality, production capacity and market share. As such, it is generally able to price its domestic sales at a premium over average domestic prices for most of its products.
- ✓ The Group's production capacity, sales and net profit have achieved a CAGR of 67.3%, 46.6% and 65.7%, respectively, from FY2003 to FY2005. With a shift in product mix, better operating efficiency and full results of consolidated earnings from acquisition in 2005, the Group's net profit margin improved to 13.1% (more than doubled with FY2005 margin at just 6.3%) in the first 3 months of FY2006 after a decline in FY2005.
- ✓ Priced at 11.4x to 13.6x FY2006E P/E, valuation of the counter is competitive when compared with its major rival Lee and Man Paper Manufacturing (stock code: 2314) of 14.8x forward P/E.

Weaknesses/Threats

- × The main raw materials used to produce containerboard are recovered paper and kraft pulp. Owing to short supply of such raw materials in China, paper manufacturers import most of such raw materials and are therefore exposed to international price fluctuation.
- × The overall paper manufacturing industry in China, including the containerboard segment, is relatively fragmented with a large number of manufacturers. Nonetheless, due to the capital intensity, environmental sensitivity and constraints on raw material supplies, there are significant entry barriers to large-scale paper manufacturing operations.
- × The Group is highly leveraged. Its net gearing ratio stayed about 200% in FY2003 to FY2005. As of 30th September 2005, the Group's total bank borrowings amounted to RMB6,004 million. With the interest rates staging to rise further, it is inevitably that the Group's interest expense is expected to climb further.

Recommendation: Trading Buy

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