

Analyst: Kelvin Li

Main Board Listing – Research

Sinotruk (Hong Kong) Limited [Stock Code: 3808] 中國重汽(香港)有限公司

Joint Global Coordinators and Joint Bookrunners : CICC JPMorgan
Joint Sponsors and Joint Lead Managers : CICC (HK) JPMorgan (Asia Pacific)

Sector : Capital goods

Business : Manufacture of heavy trucks

<p>Total share offer: <u>702,000,000</u> shares (31.9% of the enlarged share capital)</p> <p>Public Offer: 70,200,000 shares (10%)</p> <p>Placing: 631,800,000 shares (90%)</p> <p>Greenshoe: 105,300,000 shares</p>	<p><u>Business of Sinotruk</u></p> <p>Sinotruk, along with its parent company – China Heavy Truck Group (owned by Shandong Provincial Government), is the largest heavy truck manufacturer in the Mainland in terms of sales volume during the first 3 quarters of 2007.</p> <p>Sinotruk specializes in the research, development and manufacture of heavy trucks and related key parts and components, including cabins, engines and axles. The Group's principal products include cargo trucks and truck chassis with gross vehicle weight (GVW) over 14 tonnes and semi-tractor trucks with trailing capacity over 12 tonnes. Sinotruk's major product series include <i>HOWO</i> (豪濶), <i>Sitaier King</i> (斯太爾王), <i>Sitaier</i> (斯太爾) and <i>Huanghe</i> (黃河). The Group mainly sells its trucks in China, while it is also expanding the export market aggressively.</p> <p>Sinotruk's production facilities are strategically located in the most industrialized and economically developed areas, with its headquarters and principal production base in Jinan, Shandong province. The Group also produces its engines in Hangzhou and parts and components in Chongqing.</p>
<p>Price: HK\$10.00 – HK\$12.88 per share</p> <p>Market Cap: HK\$22.02 billion–HK\$28.36 billion</p> <p>Pro forma FY2007E PER: 21.1x to 27.1x</p> <p>Adjusted NTA per H share: HK\$3.84 - HK\$4.71</p> <p>Staffing: 13,944 (as of 30th September 2007)</p>	
<p>HK Public Offer period: 15th November 2007 – 20th November 2007 noon</p> <p>Receiving bank: Bank of China (Hong Kong) Bank of Communications (HK) ICBC (Asia)</p> <p>Share registrar: Computershare Hong Kong Investor Services Limited</p> <p>Listing date: 28th November 2007</p>	

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

Sinotruk (BVI) – wholly owned by Shandong Provincial Government	64.9%
The PRC National Social Security Fund (NSSF)	3.2%
Public Investors	31.9%
	<u>100.0%</u>

*A group of corporate investors has agreed to subscribe for an aggregate US\$200 million of the IPO offering. Subscriptions of the corporate investors include US\$12.5 million each for **Li Ka Shing Foundation** and **Cheung Kong (Holdings)**; US\$25 million each for **China Life**, **Bank of China**, **Mr. Kuok Hock Nien**, **Chow Tai Fook Nominee Limited**, **Mr. Yung Chi Kin**, **Dickson Poon family**, and **Government of Singapore Investment Corporation**.*

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$7,580.3 million (Assuming an offer price of HK\$11.44, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For expanding the engine manufacturing capacity and enhancing the technology level of Sinotruk Hangzhou Engine	1,200
For expanding our forging capacity and enhancing the technology level at Sinotruk Jinan Power in Zhangqiu district of Jinan	800
For expanding the Group's truck manufacturing capacity and enhancing technology level at Sinotruk Jinan Truck Company	700
For expanding the Group's truck manufacturing capacity and enhancing technology level at Sinotruk Jinan Commercial Truck Company	600
For research and development	700
For domestic and overseas market expansion	600
For debt repayment	2,500
For working capital	Remaining balance

Financial Highlights

	Year ended 31 st Dec			9 months ended	
	2004	2005	2006	30 th Sep 2006	30 th Sep 2007
	RMB million	RMB million	RMB million	RMB million	RMB million
Revenue	10,164	9,114	12,767	9,092	16,141
Gross profit	1,469	1,131	2,238	1,588	2,957
Operating profit	758	295	1,322	1,004	1,688
Profit attributable to shareholders	301	78	638	523	832
Gross profit margin	14.45%	12.41%	17.53%	17.47%	18.32%
Operating profit margin	7.46%	3.23%	10.35%	11.04%	10.46%
Net profit margin	2.96%	0.85%	5.00%	5.76%	5.15%
	31/12/2004	31/12/2005	31/12/2006	30/9/2006	30/9/2007
Net debt to Equity	N/A	N/A	622.90%	N/A	107.25%

Sales breakdown in terms of products

(RMB million)	2004	%	2005	%	2006	%	9M06	%	9M07	%
Trucks	9,143	90%	8,224	90%	12,051	94%	8,661	95%	15,202	94%
Engines	1,609	16%	1,414	16%	3,114	25%	2,105	24%	4,057	25%
Finance	7	0%	132	2%	144	1%	120	1%	83	1%
Others	10	0%	30	0%	50	0%	39	0%	49	0%
Intersegment elimination	(606)	(6%)	(686)	(8%)	(2,592)	(20%)	(1,832)	(20%)	(3,249)	(20%)
Total	10,164	100%	9,114	100%	12,767	100%	9,092	100%	16,141	100%

Revenue breakdown in geographical terms

(RMB million)	2004	%	2005	%	2006	%	9M06	%	9M07	%
Mainland China	10,067	99%	8,063	88%	11,205	88%	7,843	86%	13,450	83%
Overseas	96	1%	1,052	12%	1,563	12%	1,250	14%	2,692	17%
Total	10,164	100%	9,114	100%	12,767	100%	9,092	100%	16,141	100%

Strengths/Opportunities

- ✓ Heavy trucks are used extensively in infrastructure projects. Therefore, Sinotruk is considered as a close proxy to the fast-growing fixed-asset investments in China. China's fixed asset investment (FAI) grew 24.0% y-o-y in 2006, while urban FAI increased 26.4% y-o-y during the first 9 months this year.
- ✓ Thanks to improved quality and low cost of PRC-made truck products, China's export of heavy trucks grew rapidly over the past years. For instance, the export volume of cargo truck rose to 11,805 units in the first 3 quarters of 2007 from 6,663 units for the full year of 2006, while that of semi-tractor trucks increased to 10,041 units in Q1-Q3 2007 from 6,178 in the whole year of 2006.
- ✓ Sinotruk has obtained various ISO certificates for its manufacturing units, as it maintains strict quality control over R&D, engineering and production. An internationally recognised quality standard should strengthen Sinotruk's brandname and help the Group establish presence in the overseas market.
- ✓ The Group has 66 sales offices throughout China. It has also established sales relationships with 780 third-party companies, of which 101 were 4S (sales, spare parts, services and surveys) centres, 35 exclusive dealers and 700 contracted service stations. This extensive sales and after-sales service network should enable the Group to maintain its business relationship with its customers.
- ✓ Sinotruk's gross profit margin rose steadily over the past years, from 14.45% in 2004 to 17.53% in 2006 and 18.32% in Q1-Q3 2007, after the Group introduced high-end products and expanded its export market. Gross profit margin should continue to improve, as the Group plans to further develop its overseas sales and targets to boost its exports sales volume to one-third of the total by 2010.
- ✓ To ride on the booming Mainland economy, Sinotruk plans to increase its annual truck production capacity to 150,000 units from the current 70,000 and engine production capacity to 188,000 units from the current 100,000 by 2010.

Weaknesses/Threats

- × Weichai Power (HKEx: 2338) has alleged infringements to 4 of its utility model patents by its rivals, including Sinotruk. Sinotruk claimed that the utility model patents in dispute were either in the public domain or used by Sinotruk prior to the issuance of the patents. Sinotruk said the parts affected by the alleged infringements could be easily substituted by similar products at comparable costs.
- × Pricing at 21-27x FY07E P/E, valuation of Sinotruk is higher than rival Weichai Power, which is trading at 17x forward price-earnings multiple. Nonetheless, the valuation is not demanding given Sinotruk's aggressive expansion plan and improving gross profit margin amid overseas expansion.

Recommendation: Subscribe

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