

Analyst: Anita Hwang

Main Board Listing – Research

Qunxing Paper Holdings Company Limited [Stock Code: 3868] 群星紙業控股有限公司

Global coordinator and sole bookrunner : ICEA Capital Ltd.

Lead manager : ICEA Securities Ltd.

Joint sponsors : ICEA Capital Ltd. Access Capital Ltd.

Sector : Materials

Business : Manufacture and sale of specialty paper products

<p>Total share offer: <u>300,000,000</u> shares (30 % of the enlarged share capital)</p> <p>Public Offer: 30,000,000 shares (10%)</p> <p>Placing: 270,000,000 shares (90%)*</p> <p>Greenshoe: 45,000,000 shares</p> <p><i>*Comprising 220,000,000 New Shares and 50,000,000 Sale Shares</i></p>	<p><u>Business of Qunxing Paper (Qunxing)</u></p> <p>Qunxing primarily engages in the manufacture and sale of specialty paper products, including decorative base paper products and printing paper products. Qunxing was ranked the largest decorative base paper manufacturer in terms of the actual annual production capacity in the PRC in 2005 and 2006 by China Paper Association.</p> <p>Decorative base paper products are commonly used as the decorative layer to furnish the surface of laminated board, a decorative material which has wide applications in interior decoration of buildings, transportation vehicles, processed products such as floorboard, furniture and composite office and household wares. The decorative base paper products are sold to manufacturers of laminated boards. Meanwhile, the printing paper products are for photocopying and printing.</p> <p>Qunxing currently has 6 production lines with a total annual production capacity of 170,000 tonnes. Qunxing is planning to expand its production capacity to 320,000 tonnes by the end of 2009 by adding another 5 production lines.</p> <p>Qunxing provided a FY07E profit forecast with net profit attributable to shareholders to be no less than RMB210.0 million.</p>
<p>Price: HK\$4.10– HK\$5.35 per share</p> <p>Market Cap: HK\$4.10 billion – HK\$5.35 billion</p> <p>Pro-forma fully diluted FY07 PER: 19.0X – 24.8X</p> <p>Adjusted NTA per share: HK\$1.32 – HK\$1.62</p> <p>Staffing: 961</p>	
<p>HK Public Offer period: 17th September 07 – 20th September 07 noon</p> <p>Receiving bank: ICBC (Asia) The Bank of East Asia Bank of Communications</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 2nd October 2007</p>	

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

Mr. Zhu Yu Guo (executive director and Chairman) and Mrs. Zhu (non-executive director) via Boom Instant Limited	70.0%
Public shareholders*	30.0%
	<u>100.0%</u>

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Remarks: (*) Qunxing and the global coordinator have entered into corporate placing agreements with each of the following cornerstone investors:

- **Cheung Kong (Holdings) Ltd.** will subscribe for 32 million shares, representing 3.2% of the enlarged share capital.
- **Chow Tai Fook Nominee Ltd.** will subscribe for 32 million shares, representing 3.2% of the enlarged share capital.
- **Kerry Holdings Ltd.** through Solar Sky International Ltd., Total Upgrade Ltd. and Joyous Wing Ltd., will subscribe for an aggregate of 32 million shares (representing 3.2% of the enlarged share capital).

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,130.8 million. (Assuming an offer price of HK\$4.73, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For the settlement of the remaining balance of the construction costs of new production line No. 7	168.2
For the construction of new production lines No. 8 and 9	370.8
For the construction of new production lines No. 10 and 11	370.8
For re-engineering and modification of existing production lines No. 1 and 3	41.2
For strengthening marketing activities	41.2
For development of overseas market	30.9
For research and development	5.2
For general working capital	102.5

Financial Highlights

RMB million	Year ended 31 st December		
	2004	2005	2006
Revenue	467.2	696.4	950.8
Gross profit	84.7	133.3	184.1
Profit from operations	73.7	117.6	163.3
Net profit	44.4	68.3	93.9
Gross Margin	18.1%	19.1%	19.4%
Operating Margin	15.8%	16.9%	17.2%
Net Margin	9.5%	9.8%	9.9%

Breakdown of turnover by activities

Year ended 31 st December	2004		2005		2006	
	RMB million	%	RMB million	%	RMB million	%
Decorative base paper	467.2	100.0%	696.4	100.0%	834.2	87.7%
Printing paper	0.0	0.0%	0.0	0.0%	116.7	12.3%
Total	467.2	100.0%	696.4	100.0%	950.8	100.0%

**Strengths/Opportunities**

- ✓ **Strong demand** for decorative base paper is expected to grow amid strong demand for laminated board used in furniture and construction materials. Growing urbanization and rising disposable income are expected to drive the demand for housing, which in turn will drive the demand for furniture and construction materials.
- ✓ **Reasonable valuation** The IPO price range of Qunxing at a FY07E pro-forma fully diluted PER range of 19.0X – 24.8X should be reasonable when compared with its peers. There is no direct comparable company listed in HK that is engaged in the manufacture of specialty paper products. HK-listed peers involved in the manufacturing of paper-related products include Lee & Man Paper (2314.HK) and Nine Dragon Paper (2689.HK), with the respective FY07E PER of 34.2X and 29.8X. Qunxing's valuation would be at 22%-40% discount to these 2 companies, which we think is reasonable for Qunxing's smaller production scale and lower gross margin (by 4 percentage points).

Weaknesses/Threats

- × **Risks from hike in raw materials prices** Wood pulp and titanium dioxide are the two key raw materials for the Group. Purchase costs for wood pulp and titanium dioxide accounted for 40.5% and 31.0% respectively of total cost of sales of the Group in FY06. Global wood pulp prices have been on the rise as demand outgrows supply. The supply and demand conditions in China is even tighter with over 40% of the total consumption of wood pulp in 2005 in China coming from imported wood pulp. For Qunxing, the total purchase cost of wood pulp in FY06 was RMB310.5 million. It is estimated that for every 1% increase in total purchase cost of wood pulp, net profit would have decreased about RMB2.1 million (2.2%). Similarly, for every 1% increase in total purchase cost of titanium dioxide, net profit would have decreased about RMB1.6 million (1.7%). Therefore, any fluctuation in the prices of these raw materials can materially affect the profitability of Qunxing.

Recommendation: Subscribe



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