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HONG KONG RESEARCH
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Main Board H-share Listing – Research

中海石油化學股份有限公司
China BlueChemical Ltd [Stock Code: 3983]

Joint Global Coordinators, Joint Bookrunners, Joint Sponsors and Joint Lead Managers : JP Morgan UBS AG

Sector : Materials
Business : Production of nitrogenous fertilizer

Total share offer: 1,400,000,000 H shares
(31.82% of the enlarged share capital)

Public Offer: *140,000,000* H shares (10%)

Placing: *1,260,000,000* H shares (90%)

Greenshoe: *210,000,000* H shares

Price: HK$1.38 – HK$1.90 per H share

H-share Market Cap: HK$6,072 –8,360 million

Forcasted FY06 net profit: not less than RMB1,460.5 million

Pro-forma FY2006E P/E: 7.0x – 9.7x

Adjusted NTA per H share: HK$1.156-HK$1.315

Staffing: 4,279 (as of 30th June 2006)

HK Public Offer period:
18th September 06 – 21st September 06 noon

Receiving bank: Standard Chartered Bank (HK)
Bank of Communications

Share registrar: Computershare Hong Kong Investor Services Limited.

Listing date: 29th September 2006

Business of China BlueChemical

BlueChemical is one of the largest nitrogenous fertilizer manufacturers in the Mainland and a subsidiary of CNOOC. The Company's core business is the production and sale of urea, the most commonly used nitrogenous fertilizer in China.

In order to strengthen its production scale, BlueChemical acquired a 90% stake in Tianye Chemical in March 2006, which helped boost its production capacity of urea to 1.84 million tonnes per annum. The Company's three urea production facilities are located at Hainan and Inner Mongolia, namely Fudao Phase I, Fudao Phase II and Tianye Plant. Fudao Phase II is currently the largest single urea production facility in the Mainland.

Beside urea production, BlueChemical is also engaged in the production of methanol. Trial production has commenced in Sep 06, while mass production is expected to begin by Jan 07.

Natural gas is the major raw material used in BlueChemical's production. Natural gas used in the Company's Hainan plants and Tianye Plant were mainly supplied by its sister company, CNOOC Limited (HKEx: 0883), and PetroChina (HKEx: 0857) respectively.

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

CNOOC, also the parent company of HK-listed CNOOC Limited	62.73%
Zhejiang AMP, Guangdong AMP, Shanghai AMP & Transammoria (Customers of the Company)	2.27%
The National Council of Social Security Fund	3.18%
Public Shareholders	31.82%
	100%

Use of Proceeds

Net proceeds from the offer are estimated to be HK$2.2 billion. *(Assuming the over-allotment option is not exercised, and at an issue price of HK$1.64 each, being the mid-point of the indicative price range)*

	RMB million
For new product development, primarily to finance the construction of a production facility for the manufacture of polyoxymethylene at Tianye plant.	1,400
To repay partially a RMB denominated short-term financing in relation to a long-term bank loan (in Japanese Yen) from Bank of China totalling an amount equivalent to RMB1.07 billion as of 31st December 2005.	500
To repay partially a RMB denominated short-term financing in relation to long-term bank loans (in Japanese yen) owing to Export-Import Bank of China in the amount equivalent to RMB1.45 billion as of 31st December 2005.	103.2
For general working capital	Remaining balance

Financial Highlights

	Year ended 31st December			6 months ended	
	2003 RMB million	2004 RMB million	2005 RMB million	30th June 2005 RMB million*	30th June 2006 RMB million*
Turnover	738	2,027	2,371	1,132	1,614
Gross profit	262	932	1,078	509	621
Operating profit	186	797	1,020	478	602
Net profit	**166**	**768**	**983**	**457**	**1,109#**
Gross margin	35.5%	46.0%	45.5%	45.0%	38.5%
Operating margin	25.2%	39.3%	43.0%	42.2%	37.3%
Net profit margin	22.4%	37.9%	41.5%	40.4%	68.7%

* Unaudited figures; # Included an excess of RMB578 million over the cost of acquisition for Tianye Chemical

Strengths/Opportunities

- ✓ Demand for mineral fertilizers in China is rising on robust economic growth and favourable government policy. From FY03 to FY05, the Company recorded CAGR in revenue and net profit at 79% and 143% respectively.
- ✓ Natural gas is the principle raw material of the Company and natural gas based production of urea and methanol is more efficient. The Company can secure stable and reliable natural gas supply given its connection with the parent company, CNOOC. Moreover, the Company's production complex in Hainan is conveniently and strategically located near its major natural gas supplies, thereby saving transportation cost.
- ✓ The IPO price range indicates a FY06E PER of 7.0X – 9.7X (excluding non-recurring RMB578 million accounting gain), which is attractively valued compared to its Hong Kong listed counterparts SinoChem (HKEx: 0297), trading at about FY06E PER 18X.

Weaknesses/Threats

- × The Company's newly acquired Tianye Chemical's gross margin is just at a high single digit. The acquisition partly explained the Company's drop in gross margin from 45% in 1H05 to 38.5% in 1H06. Also, it takes time to see whether the Company can successfully integrate with Tianye Chemical.
- × Natural gas accounts for some 40% of cost of sales. The Company's margin is subject to the fluctuations of natural gas price movement. In additional, the 15% upward price ceiling from the base price set by National Development and Reform Commission of the PRC for nitrogenous fertilizer limits the Company's capability to maintain margin in case there is a surge in material cost.
- × 56% of the Company's bank loan (or RMB381 million) is dominated in Japanese Yen. Appreciation of Yen against RMB would have a negative impact on the Company's bottom line.

Recommendation: Subscribe

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