

**Benefits from lower oil price****China Petrochemicals****Jilin Qifeng (549 HK, HK\$1.12)****Not Rated**

**Company background.** Established in Dec 1995, Jilin Qifeng (QF) is the 2nd and 5th largest acrylic fibre producer in the PRC and the world in terms of production capacity. It has an 11.6% market share in PRC, only second to Shanghai Petrochemical. In addition of its own production capacity of 136k tpa, it formed a 50:50 JV with Italy's Montefibre which has commenced operation in mid-Oct 2006 to produce acrylic fibre. The JV will add another 100k tpa to its existing capacity. This JV will specialize in producing differentiated fibers, on top of the regular fibers QF which it has been producing. State-owned Jilin Chemical Fibre Group Company is the major shareholder with a 50.01% stake. Apart from acrylic fibre, Jilin Chemical Fibre Group also produces viscose fibre, rayon fibre and pulp. QF was listed in June, 2006 at HK\$1.69 per share.

**Major products.** The major product of QF is regular acrylic fibre, a synthetic material used as a substitute for wool which is widely used in apparels, home furnishing and industrial applications, such as sweaters, socks, fleece wear, sportswear, blankets, rugs, luggage, awnings, asbestos substitute, concrete and stucco reinforcement. QF's acrylic fibre products can be classified into three categories, namely Acrylic Top, Acrylic Tow and Acrylic Staple Fibre. They accounted for 36.6%, 33.3% and 29.6% of total sales in FY12/05. Apart from regular acrylic fibre, QF also produces three types of differentiated fibers with higher value-added and higher margin products currently. The new JV is able to produce seven types of differentiated fibers. ASP for differentiated acrylic fibre is 8-10% higher compared with that of regular ones. However, differentiated acrylic fibre only accounted for 7% of QF's total sales in FY12/05, but the contribution is expected to increase upon the commencement of the new JV.

**Major customers and suppliers.** QF's products are sold domestically under the brand name Baishan. Its major customers are wool yarn manufacturers in more than ten provinces in the PRC. It does not have any long-term contract with these customers. Its major raw material is acrylonitrile, which accounted for over 90% of its total raw material costs. QF secures over 90% of its total acrylonitrile consumption from CNPC Jilin Chemical, through an 8.4km pipeline, where QF's purchase represents around 70-80% of CNPC Jilin Chemical's output.

**Industry landscape.** Although global demand for acrylic fibre was flat in 2000-05, the demand in PRC rose at a CAGR of 8% during the same period. According to the projection of PCI Acrylonitrile Ltd, demand for acrylic fibre in China is expected to increase at a CAGR of 7% during 2005-09. A lot of the people is misguided by the oversupply situation of polyester in China as the market landscape for acrylic fibre is completely different. China still relied on net imports for 39% of the supply of acrylic fibre in 2005.

**Benefits from lower oil price.** We see that QF's profitability is highly linked to the price of its key raw material, acrylonitrile and its average product price. They are in turn linked to 1) international crude oil price and 2) the balance of supply and demand of acrylic fibre and 3) potential substitutes such as wool and other fibers in the PRC. As seen from its 1H06 results, QF earnings fell 25.9%, reflecting the negative impact from rising crude oil price. During 1H06, international crude oil price rose 21.1% from US\$61/barrel in Jan to US\$73.9/barrel in June. This has prompted acrylonitrile price to rise 11.3%. Moreover, average product price during the period also fell by 2.2% because there were two new acrylic fibre plants entering the market at the end of 2005. As a result, QF's gross and operating margins declined by 2.6% to 14.3% and 9.7% respectively. Recently, the international crude oil price fell sharply by c.18% to US\$60.6/barrel on 23<sup>rd</sup> Oct, 2006 compared with US\$73.9/barrel in June. However, acrylonitrile prices usually lag behind international crude oil price by 1 to 2 months. As a result, we expect QF will benefit from the abating oil price in 4Q06 together with a stabilizing average product price. Moreover, the JV will add an attributable 100k tpa to its existing capacity, representing an increase of c.36%.

**Lowly-valued.** QF is a niche-player as it specializes in acrylic fibre, which differs from others who produce mainly polyester and viscose fibers. There are only two direct comparables, namely Aksa Akrilik (AKSA TU,

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based in Turkey) and Montefibre (MF IT, based in Italy). MF is loss-making because increasing global demand for acrylic fibre has been switched to South Asia. QF commands a higher operating margin than AKSA reflecting its higher operating efficiency. Most important of all, QF is cheaply valued at 6x in FY12/07F P/E, much lower than 18x for Akasa Akrilik (AKSA TU).

**Table 1: Peer comparisons**

Ticker	Stock	Currency	Open Price	Mkt Cap. (US\$m)	P/E (x)			Gross margin (%)	EBIT margin (%)	Major product
					05A	06F	07F			
AKSA	Aksa Akrilik	TRY	14.6	266.5	n.a.	31.3	17.8	0.0	7.93	acrylic fiber
MF	Montefibre	EUR	0.327	65.2	n.a.	n.a.	n.a.	(8.1)	(8.1)	acrylic and polyester fiber
600527	Jiangsu Jiangnan	CNY	4.4	119.4	27.3	n.a.	n.a.	0.0	13.37	polyester tops and composite short fiber
000677	Shangdong Helon	CNY	3.34	165.0	16.2	n.a.	n.a.	10.4	10.41	viscose staple fibers
000420	Jilin Chemical Fibre	CNY	2.65	122.0	30.7	n.a.	n.a.	5.8	5.84	viscose staple fibers
000498	Dandong Chemical	CNY	2.39	116.9	n.a.	n.a.	n.a.	0.0	10.02	viscose staple and polyester fibers
FBCM	Fibrechem	SGD	1.66	408.9	13.8	10.6	7.0	29.6	29.55	polyester
CSCF	China Sky Chemical	SGD	1.31	579.7	12.9	9.8	7.4	31.5	31.5	nylon
CGT	CG Technologies	SGD	0.41	66.8	6.02	n.a.	n.a.	n.a.	21.36	polyester
HONG	Hongwei Technologies	SGD	0.255	30.8	4.8	n.a.	n.a.	27.5	27.53	polyester
549	Jilin Qifeng	HKD	1.12	124.7	4.7	7.3	5.9	11.2	11.16	acrylic fiber
1033	Sinopec Yizheng	HKD	1.42	1,585.8	n.a.	42.4	26.2	(6.0)	(6.0)	polyester
<b>Average</b>					<b>14.6</b>	<b>20.5</b>	<b>12.9</b>	<b>9.3</b>	<b>12.9</b>	

Source: SBI E2-Capital

**Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Co-Manager and SBI E2-Capital (HK) Limited, an affiliate of SBI E2-Capital Securities Ltd., was the Joint Sponsor for the IPO of Jilin Qifeng on 20<sup>th</sup> June, 2006 (236.25m H shares at HK\$1.69). SBI E2-Capital (HK) Limited now acts as the compliance advisor of Jilin Qifeng.**