

Sanjiang Chemicals

Largest private EO producer in China

To summarize...

- 3rd largest producer with 20% production market share in China in a concentrated space (top 3 producers account for 85% of production). Sanjiang is the largest private enterprise producing EO in China.
- Entry barriers are extremely high. New entrants need to have minimum production capacity of 200,000MT, requiring significant upfront investment.
- All EO produced in China are sold in advance. There is a demand/supply gap of around 30%. This supply gap is presently met by importing of downstream surfactant products, which is cost ineffective.
- Continuing growth in demand expected. According to management, China currently produces around 300 products which uses downstream surfactants. In contrast, the US/Europe produces around 3,000 applications.
- Stock is depressed due to market conditions and exit of pre-IPO investors post listing.

Valuation: Company is trading at historical 6.0x FY12/10A and ~5.0x FY12/11F P/E on a fully diluted basis

Company profile: China Sanjiang Fine Chemicals (Sanjiang) is a manufacturer and supplier of consumer related chemicals, namely ethylene oxide (EO) and alcohol polyoxyethylene ether (AEO) surfactants, which are mainly used as core components in many everyday use items (cosmetics, personal care products, household cleansing products, polyester fibre, PET resin, solvents, brake fluids, PU, water reducer agents etc). Around 80% of the company's revenues are derived from sales of EO. The company is China's only private enterprise producing EO with around 20% market share (3rd largest) in China. Sanjiang is based in Jiaying, Zhejiang Province and was established in 1998 (formerly named Hangzhou Haoming).

Demand/supply gap of EO. EO is a derivative of ethylene, which is used to produce surfactants. As EO is an extremely combustible material, it is extremely difficult to transport and thus there is minimal export/import of EO. Import volumes of EO in 2009 is <1%. All EO is used to produce in China is consumed domestically. According to the management, actual demand for EO outstrips supply by around 30%. Presently, this demand supply gap is met by importing of downstream AEO surfactant products, which are more costly and also has import duties of 6.5%. EO feedstock is ethylene, which the company imports. The import of ethylene carries a duty of 2%.

Market Players. Producers of EO is extremely concentrated. 12 producers supply the entire demand in China. Sanjiang holds 20%+ market share and is the third largest and the largest private enterprise. Sinopec (386.HK) is the largest, with around 40%+ and Petrochina is 2nd, with around 25% share. Barriers to new entrants are extremely high. New entrants need to have a minimum of 200,000MT capacity, which would require a significant upfront investment.

Customer base. Company signs annual offtake agreements (by volume) with customers at the end of each year for demand for the following year. Prices are based on spot prices during the year. 95% of customers sign offtake contracts. Therefore, visibility going into each year is high and locked in. 75% of sales is sold directly to customers with 25% sold to trading distributors. 5 largest customers account for 60% of sales with the largest accounting for 20%.

Ticker	2198 HK
Rating	Not Rated
Price (HK\$)	1.95
Target Price (HK\$)	n.a
12m Price Range (HK\$)	1.80-3.55
Market cap. (US\$m)	252.2
Daily t/o (US\$m)	0.4
Free float (%)	53.5

Financial summary

Year to Dec	08A	09A	10A
Turnover (HK\$m)	953	1,286	1,583
Net Profit (HK\$m)	162	242	266
EPS (HK\$)	0.160	0.258	0.264
P/E (x)	11.6	6.6	6.0
P/B (x)	4.7	6.9	1.2
EV/EBITDA (x)	7.9	5.5	3.5
Yield (%)	-	-	-
ROE (%)	39%	49%	13%
ROCE (%)	16%	29%	13%
N. Gear. (%)	213%	261%	14%

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (HK\$)	-	-	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(15.7)	(15.5)	(11.4)
Actual price changes (%)	(13.7)	(11.4)	(29.1)



Source: Bloomberg

Research Team

(852) 2533 3700
sbie2research@sbie2capital.com

Core competency. Sanjiang core competency is its refining capability, scale and logistics management. Note that due to the combustible nature of EO, the company only keeps inventory for 1-2 days only. They also have port access, which is a strategic cost advantage for the import of feedstock ethylene.

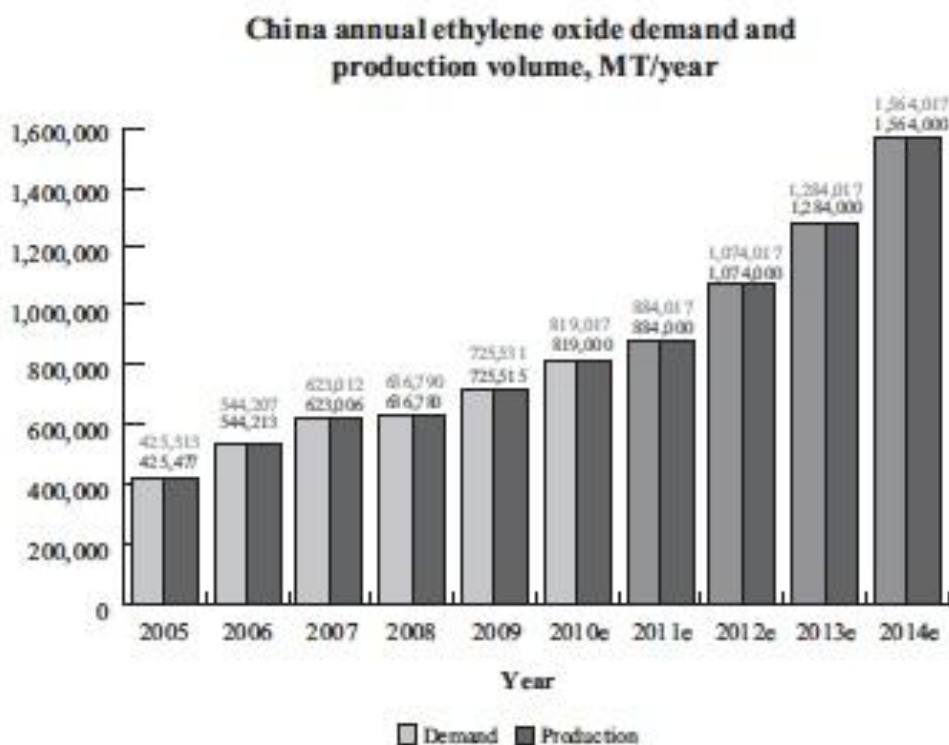
Table 1. Capacity and utilization

Capacity (MT)	08A	09A	10A	11F	12F
Design capacity	65,000	120,000	120,000	165,000	230,000
Production vol	67,780	140,515	132,818	173,000	242,000
Utilisation rate (%)	104.30%	117.10%	110.70%	104.80%	105.2%

Source: SBI E2-Capital

Market Size. We expect continuing growth in demand. According to management, China currently produces around 300 products which uses downstream surfactants. In contrast, the US/Europe produces around 3,000 applications.

Chart 1. Market Size



Source: Sanjiang Chemicals

Key Management.

- Guan Jianzhong (Chairman & Executive Director). Guan has 25 years of chemical industry experience. Between 1985-1996, Guan worked at SOE, Hangzhou Electrochemical Group Co. Ltd., focusing on surfactant research and development department. In addition to his role at Sanjiang, Guan has also served Yongming Petrochemical and Jiahua Industrial Park Co. as Chairman of the Board.
- Han Jianhong (Executive Director) - Spouse of Guan, Han has 12 years experience in the chemicals industry and founded Hangzhou Haoming with Guan.

Table 2. Shareholding Structure

Major Shareholder	%
Guan Jianzhong (Chairman & Executive Director) / Han Jianhong (Executive Director)	46.30
Delta Lloyd Asset Management	5.00

Source: SBI E2-Capital

Others

- Auditor: Ernst & Young
- Capital market history: Sanjiang was listed on the HKEx in Sep 2010, raising HK\$897m gross proceeds
- Cash position: As at 1H FY12/10A, company had a net cash position of RMB252.4m

Risks - 1) EO spot pricing based on Sinopec prices, 2) substantial increase in production capacity

Table 3. Summary P&L

Summary P&L					
Y/E Dec (RMBm)	08A	09A	10A	1H 10A	1H 11A
Revenue	952.8	1,285.50	1,582.50	831.2	890.4
Gross profit	224.5	356.3	360.2	160.5	186.2
Net profit	139.1	242.1	266.1	110.7	158.2
YoY Chg (%)	08A	09A	10A	1H 10A	1H 11A
Revenue		34.90%	23.10%		7.10%
Gross profit		58.70%	1.10%		16.00%
Net profit		74.10%	9.90%		42.90%
Margins (%)	08A	09A	10A	1H 10A	1H 11A
Gross margin	23.60%	27.70%	22.80%	19.30%	20.90%
Net margin	14.60%	18.80%	16.80%	13.30%	17.8%

Source: SBI E2-Capital

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months

BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Financial Services Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Financial Services Limited. All rights reserved.