

Grow through capacity expansion

China Industrials

Qunxing Paper (3868 HK)

Not Rated

Table 1: Offer stat

Offer price range	HK\$4.10 - 5.25
No. of share offered	300,000,000
Green shoe	15.0%
Offer P/E (FY2006F)	31.5x - 40.4x
Market cap	US\$1,230m -1,575m
IPO opens	17-Sep-07
IPO closes	21-Sep-07
Listing	2-Oct-07

Source: Company data

Company background. Founded in 1999, Qunxing Paper is engaged in the manufacture and sale of specialty paper products, such as decorative base paper and printing paper. Decorative base paper products are commonly used as the decorative layer to furnish the surface of laminated board. It is used in interior decoration of furniture, fortified wooden floorboard, buildings and transportation vehicles. Most of the company's customers are laminated boards manufacturers. In 2005 and 2006, the China Paper Association named Qunxing Paper as China's largest decorative base paper manufacturer.

Production plant and capacity. At its production base, located in Binzhou City, Shandong province, the company operates six automated paper production lines with a total annual capacity of 170,000 tonnes.

Table 2: Production capacity

Production line no.	Date of commencement	Annual production capacity (tonnes)
1	Oct-99	10,000
2	Aug-02	20,000
3	May-03	30,000
4	Aug-04	50,000
5	Apr-06	30,000
6	Apr-06	30,000

Source: Company data

Table 3: Turnover breakdown

Year end Dec (RMBm)	2004	%	2005	%	2006	%
Decorative base paper	467.2	100.0	696.4	100.0	834.2	87.7
Printing paper	-	-	-	-	116.7	12.3
Total	467.2	100.0	696.4	100.0	950.8	100.0

Source: Company data

Table 4: Gross margin by product

(%)	2004	2005	2006
Decorative base paper	18.1	19.1	20.2
Printing paper	-	-	13.3

Source: Company data

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

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

Analyst certification: the views expressed in this report accurately reflects 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: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

Raw materials. The principal raw materials for decorative base paper products and printing paper products are wood pulp and titanium dioxide powder. Together they account for c.70.0% of the company's total production costs. The company buys wood pulp from local distributors, who import from overseas. Its titanium dioxide powder is also purchased locally. The recent price increases did not have any impact, as the company was able to pass them down to customers.

Demand to rise further. China's production and consumption of laminated board has been on the rise in the last few years driven by rising consumer spending and GDP and at the moment there is a slight shortage in the market. We expect the demand to rise further, fuelling demand for decorative base paper products by 20% a year in the next 10 years.

Favorable government policy. Laminated board is more environmentally friendly than wood or plastic. In recent years, the Chinese government has been encouraging the use of wood pulp instead of wood and timber in the manufacturing of paper products. This policy will help fuel demand for decorative base paper products, which are a key material for making laminated board.

Investment highlights.

- ❑ Well positioned to tap market opportunities presented by China's national policies and to capitalise on the growing demand for decorative base paper products;
- ❑ Plans to add five new paper production lines by 2009 boosting capacity to 320,000 tonnes from 170,000 tonnes to take advantage on economies of scale and become more competitive;
- ❑ Increasing use of decorative base paper products;
- ❑ Given the increase of personal spending and GDP, increasing in demand for laminated board and decorative paper base products is expected to driven by furniture and decoration industries.

Use of proceeds:

- ❑ To settle the remaining construction costs of its new production line no. 7;
- ❑ To build new production lines no.8, no.9, no.10 and no. 11;
- ❑ To renovate and modify existing production line no.1 and no.3;
- ❑ To strengthen marketing activities, the development of overseas markets and research;
- ❑ As general working capital.

Valuation. There is no financial forecast provided. The offer price of HK\$4.10- 5.25, representing a historical P/E of 31.5–40.4x, is rather aggressive compare to peer's average current P/E of 25.2x.

Table 5: Margin trend

Margin (%)	2004	2005	2006
Gross profit	18.1	19.1	19.4
Net profit	9.5	9.8	9.9

Source: Company data

Table 6: P&L

Year end Dec (RMBm)	2004	2005	2006
Turnover	467.2	696.4	950.8
Cost of sales	(382.5)	(563.1)	(766.7)
Gross profit	84.7	133.3	184.1
Other revenues	0.4	0.7	0.7
Selling expenses	(5.1)	(7.0)	(9.6)
Administrative expenses	(6.3)	(9.4)	(11.9)
Operating profit	73.7	117.6	163.3
Finance costs	(5.3)	(13.8)	(20.6)
Before tax profit	68.4	103.8	142.7
Income tax	(24.0)	(35.5)	(48.8)
Profit for the year	44.4	68.3	93.9
EPS -basis (RMB)	0.06	0.09	0.13

Source: Company data

Table 7: Peer comparison

Company name	Ticker	Market Cap (US\$m)	P/E (x)		ROA (%)	ROE (%)
			Current	1-yr forward		
Hung Hing Print	450 HK	322.8	9.7	8.0	6.9	13.2
Samson Paper	731 HK	119.1	18.2	18.0	2.4	7.6
Chuetsu Pulp and Paper Co.	3877 JP	245.8	23.2	140.6	na	na
Daio Paper Corp.	3880 JP	1,030.4	23.5	22.0	1.2	3.7
Paperlinx Limited	PPX AU	1,224.9	16.4	10.9	1.8	5.0
Shandong Huatai Paper Co.	600308 CH	2,275.9	33.2	26.6	5.7	15.8
Yueyang Paper Co.	600963 CH	1,688.2	52.5	29.7	1.5	5.2
Average			25.2	36.5		

Source: Bloomberg, SBI E2-Capital