

IPO Alert:

China National Building Material Company Limited

March 2006

The construction industry in Asia includes many high impact sectors from an environmental, social and governance (ESG) stand point. The Hong Kong listing of China National Building Material Company Limited (CNBMC) scheduled for March 23rd 2006 provides the opportunity to assess the ESG variables of a leading building materials company that is one of China's major cement producers and manufacturers of light weight building materials, fibre glass and fibre glass reinforced plastics, as well as being an international engineering services provider.

A review of the listing prospectus provides some insights into the following ESG issues:

- The highly energy intensive nature of the company's operations and how it secures its energy supply through the direct purchase of coal both nationally and internationally from Inner Mongolia, the planned construction of a small waste heat power generator capable of generating 72.6 million kWh of power annually by the end of 2006 and the purchase of electricity. Fuel and power costs typically accounted for over 50% of the total cost of sales during the track record period
- How substantially all production plants have adopted pollution control measures to address air emissions, installed environmental protection facilities and have designated full-time environmental compliance officers
- Significant increases in labour costs during the track record period. The company employs of the order of 8,793 employees two-thirds of whom are in production. Labour costs increased by 40% from 2001 – 2002 and 22.6% from 2002-2003
- The lack of insurance to cover risks related to the company's operations such as accidents on the companies premises
- The lack of legal title in relation to both company owned land and buildings and also leased land. This represents 5.75% of land currently owned or leased and also 11.5% of buildings currently owned. In addition 15 parcels out of 21 parcels of leased land are classed as collective land and should not be used for industrial purposes
- Limestone for cement production is sourced from limestone quarries in close proximity to the production facilities, which significantly reduces transportation costs
- How all clinker lines utilise relatively advanced technology—the New Suspension Pre-heater Dry Process (NSP)—which is more energy efficient. In addition the company has a policy of only acquiring NSP cement producers as part of its expansion strategy.

From our review of the prospectus, we believe that investors interested in ESG issues would be well advised to seek more information on the following issues:

- **Pollution control measures** The cement industry in China is a significant polluter of the environment, for example it is a significant emitter of air pollutants such as particulates, SO₂, and carbon dioxide, and also discharges waste water. It would be useful to know the extent and nature of pollution control technology as referenced in the prospectus to mitigate the potential environmental impacts of its operations. It is important to know whether the company or any of its subsidiaries intends to implement an environmental management system and certify to a global standard such as ISO 14001 which is commonly used by China's best companies.
- **Water consumption** Water scarcity is emerging as a significant environmental challenge in China and globally. Given that the manufacture of building materials requires substantial quantities of water, it would of interest to gain some insight into the extent of water consumption and how the company intends to secure long term water supplies.
- **Labour supply** Further explanation of the reasons for significant increases in labour costs during the track record period would be valuable, especially comment on whether this reflects a significant build up in staff numbers or compensation. It would also be useful to know what type of occupational health and safety training is provided to workers.
- **The supply chain** Supply chain issues are increasingly material with respect to ESG variables, particularly when the suppliers are in high impact industries. Coal and limestone suppliers are integral to the company's business. China's coal mines are famed for their significant ESG issues and in addition to which limestone quarries are often associated with erosion. It would therefore be worthwhile to determine how the company manages its supply chain from an ESG perspective.
- **Overseas properties** The company states that it owns land in Papua New Guinea. The nature of this investment and its purpose would be important to understand.
- **Environmental compliance** In this area, it is important to understand how management plans to address current and future environmental compliance requirements, especially air emissions, effluent discharge and water resource use.
- **Land-use title** The prospectus provides extensive disclosure on the status of land-use regarding legal entitlement. It is nonetheless difficult to determine how material this issue really is. It would therefore be useful to have further details including which of the company's facilities are affected by land use issues.

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