



IPO Alert: Nine Dragons Paper (Holdings) LTD.

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Pulp & paper companies are amongst the highest impact companies in Asia. There has been a dramatic increase in pulp & paper capacity in China over the past decade. As a result, any new listing in the pulp & paper sector, especially from China, offers a valuable opportunity to assess current environmental, social, and governance (ESG) practices in the sector and how the issues are being disclosed to investors. Nine Dragons, the largest manufacturer of containerboard products in China, is planning a Hong Kong listing in the next two weeks with pricing expected to take place on February 25th.

A review of Nine Dragon's prospectus provides some timely insights into the following ESG issues:

- How the company sources its raw materials including: i) significant quantities of waste paper from a related party company which collects the paper predominately from the US, and ii) unbleached kraft pulp from an equity joint venture in Inner Mongolia
- Relevant PRC Government policy and environmental regulations including environmental impact assessment and monitoring of construction projects, effluent discharge including sewerage, consumption of water resources, during paper manufacturing
- How the company is managing its growing water requirements (65,000 tonnes per day) and why they have been forced to invest in upriver reservoirs and desalinization facilities
- The company's belief that it has reduced power costs by one-third through the installation of 591MW of coal-fired cogeneration capacity
- How the HKSE has ruled on a range of related party issues resulting from management's control of the company's key supplier of waste paper and investment in its Inner Mongolian pulp supplier
- The background and qualifications of three independent non-executive directors who will be offered 1.16mn share options at a 10% discount to the offering price, exercisable over five years, in addition to normal director's compensation

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:

- **Effluent discharge** The Regulatory Section outlines the legalities of effluent discharge. It cites the supervisory requirements being applicable to the Group as a result of sewage discharge. It would be of interest to know whether other effluent discharges are also subject to this supervisory requirement.
- **The nature of planned capex** The prospectus states that the use of proceeds includes expenditure on paper machines 11, 12 and 13. From the Regulatory Section it is clear that paper manufacturing projects over 100,000 tonnes annual capacity require an impact appraisal to be approved by SEPA. Information as to the extent of construction to accommodate the planned expansion would be of interest.
- **Systems development** The prospectus indicates that a new ERP system is being implemented. In light of the complex operations and plans for rapid expansion, it would be useful to know whether additional systems work will be needed to long-term growth.
- **Cost of water** It would be worthwhile to have a sense of management's view of the future cost of water and estimates of future capex linked to water supplies and elimination of pollutants.
- **Raw materials supply** The Group plans to expand its annual design capacity to 5,400,000 tonnes by 2008 from the current 3,300,000 tonnes. The Group has also entered into land use agreements that would allow for expansion to 9,000,000 tonnes in the future. To supply these additional capacities, the group will require substantial raw materials – primarily recovered paper (currently 80-90%) and secondarily kraft pulp. Although the group identifies the potential source of such supplies, calculations of the tonnage of recovered paper and pulp required and the capacity of these sources to meet these requirements in the long term are not immediately evident.

Our research in this area suggests that raw materials supply is a potential constraint to the development of pulp & paper capacity in Southern China. Investors could usefully seek additional information on i) the expected yields from the soft wood forests in Inner Mongolia that will supply the woodchips and logs for the pulp and whether these are managed plantations and ii) the tonnage of recovered paper and pulp required to meet the expanded capacity.

- **Environmental compliance** In this area, it is important to understand how management plans to address current and future environmental compliance requirements, especially effluent discharge and water resource use.
- **ISO 14001** The Environmental Section does not clarify the scope of the company's ISO 14001 certification and the version i.e. 1996 or 2004. Further information useful to investors regarding ISO 14001 can be referred to in *ISO 14001:2004 What Do Investors Need to Know?* – ASrIA 2004. <http://www.asria.org/publications#iso>

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