

November it would seek to delay

than a month ago, the spread

Source: Thomson Reuters

# Chinese recycler promises to cover shortfall

## IPO watch

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**N**ovaris Renewable Resources is the latest Chinese company launching a sharemarket float in Australia. The fast-growing, clean-technology enterprise is seeking up to \$32 million.

Some Chinese companies, and speculative clean-techs in particular, have struggled with initial public offerings (IPOs) and had weak post-listing support in the past two years.

The Australian Securities and Investments Commission (ASIC) scrutinised the most recent Chinese IPO, Xiaoxiao Education, a small kindergarten company.

The Australian Securities Exchange required an undertaking from Xiaoxiao to have at least 150 Australian-resident shareholders who owned a minimum \$2000 of shares, within six months of listing. ASX will remove Xiaoxiao from the Official List if it cannot comply.

Xiaoxiao's listing challenges may have set a new regulatory benchmark for other Chinese companies wanting to list in Australia. Such companies are seen as an important new source of IPOs, but differences between

Chinese and Australian governance and regulation could temper growth.

One of Novaris's selling points is the involvement of Minter Ellison Lawyers. A Novaris non-executive director, FaiPeng Chen, is a Minter Ellison partner.

Small, unknown IPOs often struggle to attract top-tier advisory firms. Chinese IPOs, by their nature, require more due diligence because they are not well known in this market.

Heightened regulatory focus on Chinese IPOs, and IPOs generally, may be behind Novaris going to market with a stronger governance framework than many its size.

The company has eight directors, six of whom are independent. The board includes John O'Brien, managing director of Australian CleanTech, a project facilitator and index provider in this sector.

*The Australian Financial Review* understands ASIC is examining the Novaris IPO, which extended its exposure period by a week. But Novaris has so far not issued a supplementary prospectus and is confident its offer will open today.

The Novaris IPO has an unusual twist that may attract scrutiny. The founder, chairman and managing director, Qingyue Su, will pay

Novaris any shortfall between the company's actual net profit for 2009-10 and forecast net profit, in Chinese yuan.

Su's decision, which effectively underwrites the prospectus profit forecast, is buried on page 96 of the prospectus, and not mentioned in the chairman's letter or main summary in the prospectus, or the official press release, even though it is significant.

The *AFR* understands an institutional investor would only invest in Novaris if its founder agreed to cover any profit shortfall. Su has to pay the shortfall in yuan, so there is exchange rate risk for investors given the forecast is in Australian dollars. The guarantee removes some forecasting risk.

Su is clearly bullish on Novaris. His holding company, Great Rises International Investment, will hold 59.5 per cent of Novaris after it lists at the full subscription.

Another company Su is associated with will hold another 7 per cent, in turn reducing Novaris's liquidity due to heavy ownership concentration.

Su agreed to take at least 60 per cent of his dividends as Novaris shares until December 2011.

Novaris and its promoters clearly want to win over investors

and regulators. Beneath this effort lies a company that is more substantial than some IPOs its size.

Novaris recycles waste materials such as CD cases, agriculture twine, and fishing nets into polypropylene (PP) fibre-based products. The PP yarn, straps and consumer-webbing products are used to make straps on laptop bags, for example, and have industrial and agriculture uses.

Novaris estimates the cost of processing waste materials into recycled fibre-based PP pellets is 20 per cent less than using virgin (non-recycled) PP pellets, which are mostly derived from crude oil.

Many clean-techs make products that cost the same or more than traditional alternatives, but provide environmental benefits. Novaris provides clear "green" benefits (less crude oil used and fewer waste disposal issues) and is cheaper than conventional products.

This competitive advantage is driving rapid earnings and profit growth. Revenue is expected to rise from \$32 million in 2006-07 to \$73.8 million in 2009-10. Net profit is forecast to grow from \$4.4 million to \$13.8 million over this period.

Novaris's challenge is expanding capacity and cementing its first-mover advantage in a fragmented

industry. Most IPO funds are being reinvested to lift production to meet rising demand.

A higher oil price in the next few years could widen Novaris's cost advantage over non-recycled PP product and accelerate earnings growth if waste supply can be secured and production expanded.

Novaris will issue 128 million 25¢ shares at the full subscription, with 427 million shares outstanding for a \$106.7 million market capitalisation.

The forecast 2009-10 price-earnings ratio is 7.7 times and the dividend yield is 3.5 per cent, unfranked. Novaris hopes to pay 30 per cent of net profit in dividends if 2009 and 2010 net profit forecasts are met.

On balance, Novaris has a better earnings record than many IPOs its size, has its forecast profit (in yuan) underwritten by the founder and appears to have a competitive advantage.

But currency risks and low liquidity make Novaris suitable for speculators only. Small clean-tech stocks have mostly been poor investments in the past few years and several clean-tech IPOs have struggled to stay above their issue prices. Novaris is expected to list on March 18.