Exporter Briefing – Shandong Chenming Paper Holdings Limited

Introduction

Zhanjiang Chenming Pulp and Paper Co. Ltd ("Shandong Chenming") is the manufacturer of A4 copy paper exported to Australia. Shandong Chenming's parent company is Shandong Chenming Paper Holdings Limited ("SCPHL"). The manufacturer's production facility is located in the Zhanjiang City and is the largest integrated forest, pulp and paper project in China.

Zhanjiang Integrated Project

Shandong Chenming was established in 2002. The 700,000 tonne wood pulp project was a "national key project approved by State Council" and was designated a key project for China to promote "forest, pulp and paper integration". The project was awarded to Shandong Chenming by the National Development Reform Commission ("NDRC").

The project was awarded due to the national significance of maximising on Southern China's 'rich forestry resources', and to promote local economic development. At the time it was the largest integrated forest, pulp and paper project approved by the State Council.

Construction of the integrated project commenced in 2009, with the first production starting in September 2011. The capital investment was RMB 15 billion, and was anticipated to generate tax revenue of approximately RMB 1.2 billion per annum. In December 2011, the Municipal Standing Committee signed the expansion program for Phase II of the project worth RMB 11 billion, which was identified as generating RMB 800 million tax revenue p.a.

Shandong Chenming's 450,000 tpa paper machine uses bleached hardwood pulp as its fibre base. The machine is a 'Andritz' process technology machine, with the supply contract also comprising "*woodyard, fibreline, pulp drying, bale finishing and chemical recovery island*".

In Q4 2014, Chenming restarted a 200,000t/y fine paper machine at Zhanjiang mill. The machine was previously used to make newsprint in Jilin, but was relocated and upgraded to make printing & writing papers (possibly including copy paper).

For copy paper (cut size paper), the major brands and varieties for the Chinese market include Jin Mingyang, Jin Chenming copy paper, Burson Marsteller, Pik Wan days copy paper, Ming Yang, Xiangyun, Combat, Good Printed copy paper, Gung Ho, Sword copy paper. These are produced in 70, 75 & 80gsm, primarily at the Zhanjiang Chenming mill.

A [*company*] (pulp & paper industry experts) report commissioned in 2014 stated that Shandong Chenming's Annual report indicated *"that Gross profit margin on domestic sales was xx%, compared to xx% on export business across all products."*

Shandong Chenming's exports to Australia

Shandong Chenming exports via Vital Solutions Pte Ltd in Singapore that it refers to as a "paper trader" in its EQR. Vital Solutions in Singapore appears to arrange sales to Vital Solutions (Aust) Pty Ltd – the Australian importer of the goods. [*Confidential pricing*] in relation the goods are likely to be [*function, entity*] and/or Australian offices of the importer either directly or through their parent company.

Vital Solutions trade in the Australian market through their wholly owned subsidiary [Customer, details]

Ownership of Vital Solutions in Singapore is understood to be held by Asia Paper Markets, who are a global paper trading business.
[Customer name] business operates in 3 major channels:

[Customer sales channels]

AP also understands that during 2015 [Customer name] was [s*ales avenue*] paper sale in the Australian market. Whilst this product is likely to be sourced from [e*ntity, source*], it is worth noting that AP believes there is an [*benefit*] applicable on this business which should be investigated.

It is noted that the Vital Solutions EQR indicates:

> "*Price is negotiated when/as required by any party. Prevailing market prices and input costs are the major influences on price*."

The quoted extract confirms that it is prevailing prices that drive the selling prices in Australia.

Subsidies

Australian Paper included the Shandong Chenming Paper Holdings Limited 2015 Interim Report in its application. The application confirms the following:

- The company is a State Owned Enterprise;
- Was awarded the forestry, pulp and paper integrated project by a State agency, NDRC;
- Benefits from a concessional tax rate of 15 per cent as a "high and new technology enterprise" (refer "Section VI. Taxation – Section 2.1 Tax Incentives" of Shandong Chenming Holdings Limited 2015 Interim Annual Report, P. 89);
- Has benefited from a range of further government grants and tax concessions (including import duty and VAT reductions/exemptions – refer Section VI. Taxation – Section 2.2 VAT Incentives);
- As an integrated producer receives certain raw material inputs at less than adequate remuneration in China, including calcium carbonate, caustic soda and titanium dioxide;
- A number of grants received by Shandong Chenming include:

    - *Special subsidy funds for environmental protection;*
    - *Project fund for National technological support scheme;*
    - *Special subsidy fund for Songhuajiang environmental protection project;*
    - *Modification of alkaline recycling system;*
    - *Sewerage treatment and water conservation reconfiguration project;*
    - *Financial grants for technological modification project;*
    - *Zhanjiang integrated forestry, pulp and paper project;*
    - *Interest subsidy;*
    - *Railway line change compensation.*

- Policy loans at discounted interest rates (identified to various member companies within the Shandong Chenming Group of companies)

    - The Shandong Chenming has responded to the section on 'policy loans' in its EQR, however, the response has been redacted from the public file version;
    - The US investigation identified "policy loans" for the Papermaking industry based upon verification of information at Asia Symbol (a cooperative exporter);
    - Additional loans were found for SOEs (Shandong Chenming is an SOE) and for export seller's and buyer's credit.

Note VII Notes on statements of cash flow – Note 54(5) refers to an "Interest-free loan received by Jinagsu Chenming from the government" of RMB 68,000,000 for the prior period. Australian Paper requests that the Commission investigate all government loans to Shandong Chenming and establish extend of benefit received on subsidised loans.

Grants

Section 24 of the "Significant Accounting Policies and Accounting Estimates" details the "transfer of money or non-monetary assets from the government to the Group at no consideration, excluding capital considerations from the government as the owner of the group."

At "Note VII Notes on statements of cash flow – Note 54(3)" there is a disclosure of the amount of government grants received in the 2015 period as RMB 30,104,688.

Government Influence (market situation)

Shandong Chenming Paper Holding Company Limited's 2015 Interim Annual Report confirms that in recent years

> "*the impact of macroeconomic slowdown, demand was continuously weak in the paper making industry. On the other hand, new production capacity of the paper making industry had been released together over the past few years, resulting in the transitional overcapacity of some papermaking enterprises. Due to fierce competition, product prices continued to decline, narrowing profit margins of papermaking enterprises*.
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> *In the long run, the development conditions of the paper making industry are gradually improving. Currently, with basically stable production capacity, excess capacity has become the primary problem to be resolved in the industry. As 2015 is the last year of the 'Twelfth Five-Year Plan', elimination of outdated production capacity and increasingly stringent environmental policies are forcing some small and medium-sized enterprises out of the market……..Eliminating outdated production capacity will remove obstacles for the industry's development, while replenishment of and substitution of advanced production capacity will bring fresh blood and drive to the industry, conducive to a higher concentration ratio to creating a favourable industry lifecycle*."

The relevant issue is that it is not the market players that are determinants of their respective future – it is the government of China ("GOC") that determines which players will be shutdown and be closed as they cannot compete with the larger enterprises (that are, such as Shandong Chenming) SOEs that benefit from significant taxation benefits, government grants and favourable policies (i.e. policy loans) to ensure their future.

The foregoing highlights the influence of the GOC on the forestry, pulp and paper industry in China. The industry is "strategic" to the Chinese economy and therefore benefits from favourable policy treatment (via taxation benefits, grants, policy loan discounts).

Shandong Chenming also indicates that it has had to introduce tighter controls on working capital:

- Non-public offering of preference shares that will be traded for equity (likely to involve government bodies);
- Will introduce diversified financing channels to help "reduce the Company's finance expenses";
- Will leverage the financing platform of the Hong Kong finance market, to reduce finance expenses;
- Will utilise financial advantages of own Finance Company and Financial Leasing Company, to secure new sources of profit growth;
- Aims to improve international and domestic sales and "expand our export sales" to increase economic benefits.

Impact of US uncoated woodfree paper investigation

The Shandong Chenming Paper Holding Company limited 2015 interim annual report makes it evident that the company will seek to increase export activities. With the imposition of dumping and countervailing measures on Shandong Chenming, the company will seek to increase exports to well-established export market destinations such as Australia.