

Shanshui Cement [0691.HK]

Expensive Valuation After Considering M&A Potential; Downgrade to SELL

We downgrade Shanshui Cement from HOLD to SELL with a target price of HK\$3.35 (0.82x 2015E PBR, one standard deviation below the six-year average; previous target price: HK\$3.04). The company is trading at 1.13x 2015E PBR, the second highest in our coverage, due to the purchase of a 10.51% stake by Tianrui Group at HK\$5.00 in mid-February. However, with an expected mid single-digit ROE in these two years, we believe the current valuation has reflected most of the positives. Investors seeking for potential M&A or cooperation targets have better choices trading below book value. Shanshui Cement will release 2014 results in late March. We project recurring net profit in 2H14E to drop 57% year-on-year (YoY) to RMB276m as a result of weak prices.

Investment Highlights

- **Tianrui Group acquired a 10.51% stake in a block trade.** Parent company of Tianrui Cement [1252.HK] bought the shares at HK\$5.00 (1.23x 2015E PBR) in mid-February. Currently, Shanshui and Tianrui commanded about 40% market share (clinker capacity) in Liaoning province. We understand that the intention of the equity investment is to facilitate coordination between the two players and enhance their regional influence in cement prices.
- **A unique shareholding structure but excessive valuation.** With Zhang Caikui (25.09%), Asia Cement (20.9%), CNBM (16.66%) and Tianrui Group (10.51%), it should not be a surprise some investors have M&A expectation with this special shareholding structure. However, unless we see an exceptionally strong rebound in cement prices in Shandong and northeast China, we don't expect the company to achieve a double-digit ROE in these two years. Current valuation of 1.13x 2015E PBR, the second highest in our coverage, should have reflected most of the positives.
- **Better choices to play with the M&A/cooperation theme.** With a lacklustre economic outlook, it makes sense for market players to consider M&A or strategic investment with each other to strengthen coordination in their operating regions. From a PBR perspective, West China Cement [2233.HK] and TCCI [1136.HK] should be more attractive at 0.68x and 0.4x 2015E PBR, respectively. (*more on next page*)

Y/E Dec 31	2012	2013	2014E	2015E	2016E
Turnover (RMB m)	16,161	16,535	15,875	16,825	17,935
Recurring net profit (RMB m)	1,505	993	449	415	506
Net margin (%)	9.3	6.0	2.8	2.5	2.8
Recurring EPS (RMB)	0.53	0.35	0.13	0.12	0.15
Change (%)	(33)	(34)	(62)	(8)	22
PER (x)	7.2	10.6	27.8	30.6	25.1
PBR (x)	1.45	1.35	1.17	1.13	1.09
EV/EBITDA (x)	6.9	7.8	8.9	8.6	8.1

Sources: Company, CGIHK Research

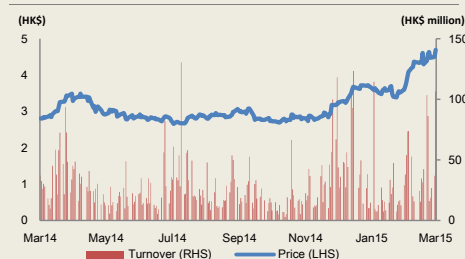
China Cement Sector

SELL

Close: HK\$4.70 (March 10, 2015)

Target Price: HK\$3.35 (-28.7%)

Price Performance



Market Cap	US\$2,047m
Shares Outstanding	3,379.1m
Auditor	KPMG
Free Float	26.84%
52W range	HK\$2.61-4.8
3M average daily T/O	US\$4.79m
Major Shareholder	Zhang Caikui (25.09%)

Sources: Company, Bloomberg

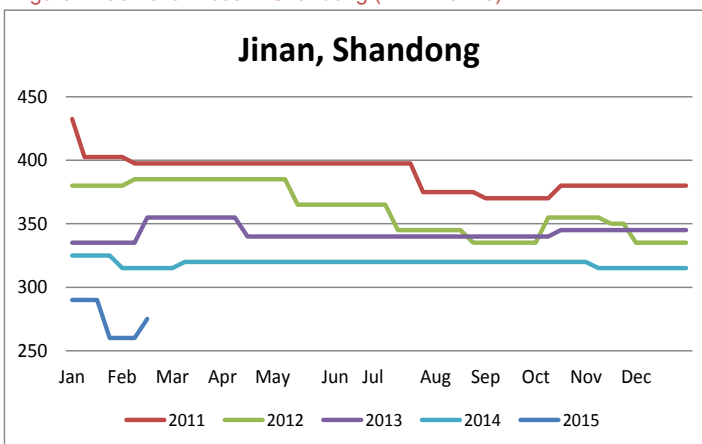
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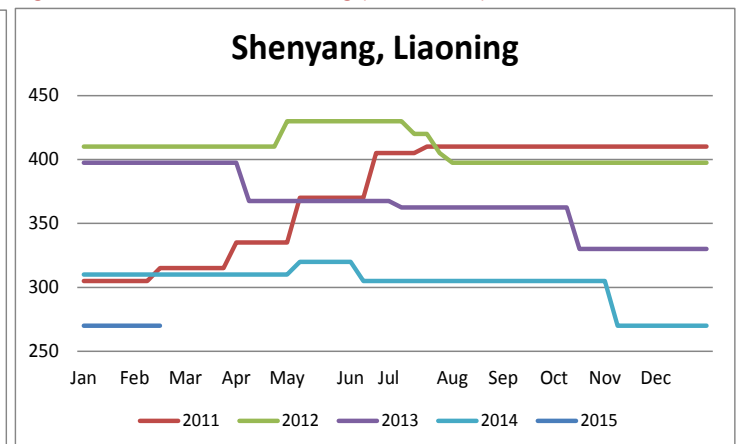
- 2H14 recurring net profit to drop 56.8% YoY due to weak priced trend.** We expect Shanshui cement's Q4 blended ASP (cement and clinker) to decline by 7.8% YoY (-6.5% QoQ), while Q4 sales volume to drop 8.1% YoY to 14.71m tonnes. We slightly trim our gross profit assumption for 2H14 to RMB50/tonne (previous: RMB53), implying a YoY decrease of 20.6%. On a full-year basis, we forecast the company's 2014E net profit to fall 54.7% YoY to RMB449.4m.
- Price trend in 1H15 likely to remain unexciting.** Latest average cement price before New Year Holidays in its major operating regions, Shandong, Liaoning and Shanxi provinces down 11%/13%/11% YoY, according to Digital Cement. Introduction of CNBM as a strategic shareholder may help reduce balance sheet risk, but we may still need a few more months to see how monetary easing measures will boost investment in 2H15.
- Cut FY14E/FY15E EPS by -21.8%/-30.1% to RMB0.133/RMB0.123.** Earnings downgrade is driven by lowering 2014E/2015E gross profit per tonne assumption by 3.8%/5.8% based on the latest cement price trend and economic outlook.

Figure 1: Cement Prices in Shandong (RMB/Tonne)



Sources: Digital Cement, CGIHK Research

Figure 2: Cement Prices in Liaoning (RMB/Tonne)



Sources: Digital Cement, CGIHK Research

Key financials

Shanshui Cement (00691.HK)

Income Statement

(RMB'000, except for per share amount)

Year ended 31 Dec	2013		2014E		2015E		2012	2013	2014E	2015E	2016E
	1H	2H	1H (A)	2H	1H	2H					
Cement	5,756,370	7,592,550	5,851,799	6,745,338	5,815,780	7,459,370	13,262,000	13,348,920	12,597,137	13,275,150	14,025,660
Clinker	801,901	998,382	913,505	935,972	864,781	1,015,744	1,904,000	1,800,283	1,849,477	1,880,525	2,038,267
Concrete and others	510,393	875,608	583,661	844,600	694,000	975,400	994,981	1,386,001	1,428,261	1,669,400	1,870,600
Revenue	7,068,664	9,466,540	7,348,965	8,525,910	7,374,561	9,450,514	16,160,981	16,535,204	15,874,875	16,825,075	17,934,527
COGS	(5,467,030)	(7,238,937)	(5,815,389)	(6,828,195)	(5,994,664)	(7,568,568)	(12,049,665)	(12,705,967)	(12,643,584)	(13,563,233)	(14,505,843)
Gross profit	1,601,634	2,227,603	1,533,576	1,697,715	1,379,897	1,881,946	4,111,316	3,829,237	3,231,291	3,261,843	3,428,684
Operating expenses	(708,378)	(861,619)	(786,970)	(835,539)	(789,078)	(907,249)	(1,300,947)	(1,569,997)	(1,622,509)	(1,696,327)	(1,783,038)
Operating profit	893,256	1,365,984	746,606	862,176	590,819	974,697	2,810,369	2,259,240	1,608,782	1,565,515	1,645,646
Other gains and losses	134,625	88,261	110,377	102,311	95,869	85,055	226,668	222,886	212,688	180,924	175,179
EBIT	1,027,881	1,454,245	856,983	964,487	686,688	1,059,751	3,037,037	2,482,126	1,821,470	1,746,439	1,820,825
Net finance costs	(453,729)	(473,432)	(553,893)	(560,035)	(541,652)	(585,567)	(881,570)	(927,161)	(1,113,928)	(1,127,219)	(1,089,090)
Profits from associates and JCEs	13,699	10,677	4,932	7,000	5,000	8,000	31,099	24,376	11,932	13,000	13,000
Non-recurrent items	(7,963)	42,516	(6,769)	-	-	-	18,423	34,553	(6,769)	-	-
Income before tax	579,888	1,034,006	301,253	411,452	150,036	482,184	2,204,989	1,613,894	712,705	632,220	744,735
Income tax expense	(219,539)	(319,643)	(149,601)	(123,436)	(60,014)	(139,833)	(601,226)	(539,182)	(273,037)	(199,848)	(217,852)
Minority interests	(12,714)	(45,291)	16,211	(11,521)	(3,601)	(13,694)	(85,234)	(68,005)	4,690	(17,295)	(21,075)
Net income	347,635	669,072	167,863	276,496	86,421	328,656	1,518,529	1,016,707	444,359	415,077	505,808
Recurring net income	352,811	640,161	172,940	276,496	86,421	328,656	1,504,712	992,972	449,435	415,077	505,808
EPS (RMB)	0.123	0.238	0.050	0.082	0.026	0.097	0.539	0.361	0.132	0.123	0.150
Recurring EPS (RMB)	0.125	0.227	0.051	0.082	0.026	0.097	0.534	0.353	0.133	0.123	0.150
DPS (HK\$)	-	0.092	-	0.033	-	0.031	0.233	0.092	0.033	0.031	0.037
Depreciation and amortization	523,131	626,537	597,455	764,527	715,447	839,873	1,038,323	1,149,668	1,361,982	1,555,320	1,665,870
EBITDA	1,564,711	2,091,459	1,459,370	1,736,014	1,407,135	1,907,624	4,106,459	3,656,170	3,195,384	3,314,760	3,499,696
Cement and clinker ASP (RMB/tonne)	241.3	242.3	234.4	226.3	223.9	230.2	266.7	241.8	230.0	227.4	228.1
Cement and clinker volume ('000 tonnes)	27,178	35,462	28,863	33,949	29,837	36,821	56,858	62,640	62,812	66,658	70,435
Gross profit per tonne (RMB)	59	63	53	50	46	51	72	61	51	49	49
Growth Rates:											
Revenue	-4%	8%	4%	-10%	0%	11%	-4%	2%	-4%	6%	7%
EBIT	-30%	-8%	-17%	-34%	-20%	10%	-21%	-18%	-27%	-4%	4%
EBITDA	-20%	-3%	-7%	-17%	-4%	10%	-13%	-11%	-13%	4%	6%
Core net income	-52%	-16%	-51%	-57%	-50%	19%	-33%	-34%	-55%	-8%	22%
Recurring EPS	-52%	-16%	-59%	-64%	-50%	19%	-33%	-34%	-62%	-8%	22%
Margins and Ratios:											
Gross margin	22.7%	23.5%	20.9%	19.9%	18.7%	19.9%	25.4%	23.2%	20.4%	19.4%	19.1%
Net margin	5.2%	7.2%	2.1%	3.4%	1.2%	3.6%	9.8%	6.4%	2.8%	2.6%	2.9%
EBIT margin	14.5%	15.4%	11.7%	11.3%	9.3%	11.2%	18.8%	15.0%	11.5%	10.4%	10.2%
EBITDA margin	22.1%	22.1%	19.9%	20.4%	19.1%	20.2%	25.4%	22.1%	20.1%	19.7%	19.5%
Effective tax rate	37%	32%	49%	30%	40%	29%	27%	34%	38%	32%	29%

Sources: Company data, CGIHK Research estimates

Key financials

Shanshui Cement (00691.HK)

Balance Sheet

(RMB'000, except for per share amount)

As at 31 Dec	2012	2013	2014E	2015E	2016E
Inventories	1,794,287	1,966,096	2,200,000	2,300,000	2,400,000
Trade receivables	594,232	1,051,543	1,150,000	1,200,000	1,250,000
Bills receivable	1,153,590	1,047,473	1,100,000	1,200,000	1,250,000
Others	1,682,390	1,901,604	1,995,635	2,085,635	2,130,635
Bank balances and cash	1,083,220	1,277,369	1,155,031	1,290,851	1,472,590
Total current assets	6,307,719	7,244,085	7,600,666	8,076,486	8,503,225
PPE, net	16,011,443	18,945,634	19,312,507	19,727,186	19,481,316
Prepaid lease payments	2,359,490	2,458,855	2,500,000	2,600,000	2,700,000
Others	3,354,725	3,587,822	4,168,435	4,391,435	4,564,435
Total non-current assets	21,725,658	24,992,311	25,980,942	26,718,621	26,745,751
Total assets	28,033,377	32,236,396	33,581,607	34,795,108	35,248,976
Trade payables	2,591,924	3,179,446	3,300,000	3,500,000	3,600,000
Other payables	1,703,342	1,847,898	1,950,000	2,100,000	2,100,000
Bank and other borrowings	1,887,309	2,909,685	3,200,000	3,500,000	3,200,000
Others	1,338,541	4,110,128	162,844	182,844	192,844
Total current liabilities	7,521,116	12,047,157	8,612,844	9,282,844	9,092,844
Bank and other borrowings	2,920,982	2,963,980	3,800,000	4,000,000	4,200,000
Others	8,194,777	7,258,533	9,740,978	9,740,978	9,740,978
Total non-current liabilities	11,115,759	10,222,513	13,540,978	13,740,978	13,940,978
Total liabilities	18,636,875	22,269,670	22,153,822	23,023,822	23,033,822
Shareholders' equity	8,650,849	9,245,952	10,711,702	11,037,907	11,460,700
Minority interests	745,653	720,774	716,084	733,379	754,454

Statement of Cash Flow

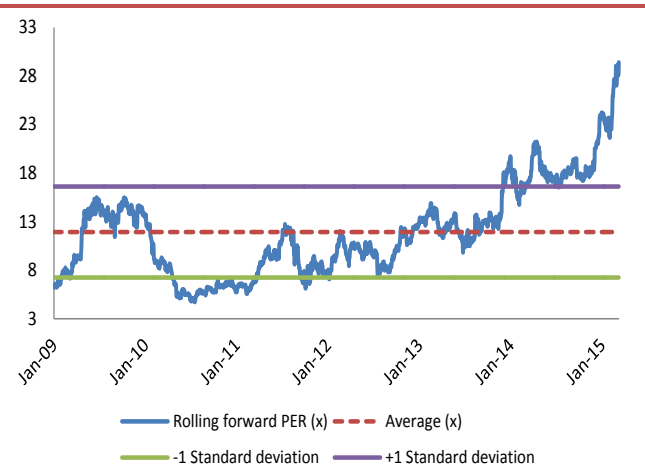
Year ended 31 Dec	2012	2013	2014E	2015E	2016E
Profit before tax	2,204,989	1,613,894	712,705	632,220	744,735
Depreciation & Amortization	1,016,086	1,165,638	1,361,982	1,555,320	1,665,870
Change in working capital	(51,807)	10,112	(262,201)	-	(150,000)
Others / adjustments	(1,239,180)	(864,893)	(556,943)	(462,848)	(395,852)
Net operating cash flow	1,930,088	1,924,751	1,255,544	1,724,693	1,864,754
Capex	(3,051,532)	(3,495,953)	(2,100,000)	(2,000,000)	(1,500,000)
Others	(1,288,400)	(39,581)	-	-	-
Net investing cash flow	(4,339,932)	(4,395,283)	(2,100,000)	(2,000,000)	(1,500,000)
Change in debt	(405,609)	2,460,739	3,666,860	500,000	(100,000)
Dividends	(551,914)	(531,428)	(205,609)	(88,872)	(83,015)
Others	1,442,787	736,194	(2,739,133)	-	-
Net financing cash flow	485,264	2,665,505	722,118	411,128	(183,015)
Increase / Decrease in cash	(1,925,112)	194,149	(122,338)	135,821	181,738
Net cash/(debt)	(12,383,131)	(15,212,454)	(14,977,439)	(15,341,619)	(15,059,880)

Finance Ratios

	2012	2013	2014E	2015E	2016E
Valuation					
PE(x)	7.2	10.6	27.8	30.6	25.1
EPS growth (%)	-33	-34	62	8	22
Yield (%)	5.0	2.0	0.7	0.7	0.8
PEG (x)	-0.21	-0.31	-0.45	-4.00	1.15
EV/EBITDA (x)	6.9	7.8	8.9	8.6	8.1
PB(x)	1.45	1.35	1.17	1.13	1.09
Operational					
Revenue growth (%)	-4	2	4	6	7
Gross margin (%)	25.4	23.2	20.4	19.4	19.1
Net profit margin (%)	9.8	6.4	2.8	2.6	2.9
Days receivables	39	42	50	50	50
Days payables	74	83	94	91	89
Days inventories	56	54	60	61	59
Current ratio (x)	0.8	0.6	0.9	0.9	0.9
Quick ratio (x)	0.4	0.3	0.4	0.4	0.4
Asset/Equity (x)	3.0	3.2	2.9	3.0	2.9
Net debt/equity (%)	132	153	131	130	123
EBITDA interest coverage (x)	4.7	3.9	2.9	2.9	3.2
Core ROE (%)	18.4	11.1	4.5	3.8	4.5

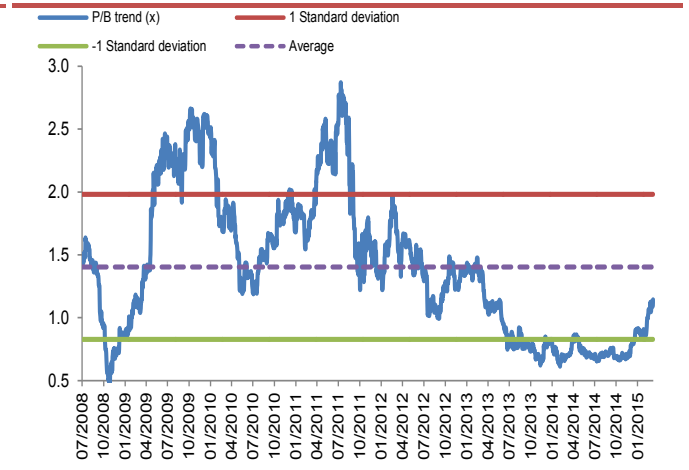
Sources: Company data, CGIHK Research estimates

Figure 3: Shanshui Cement Rolling Forward PER Range



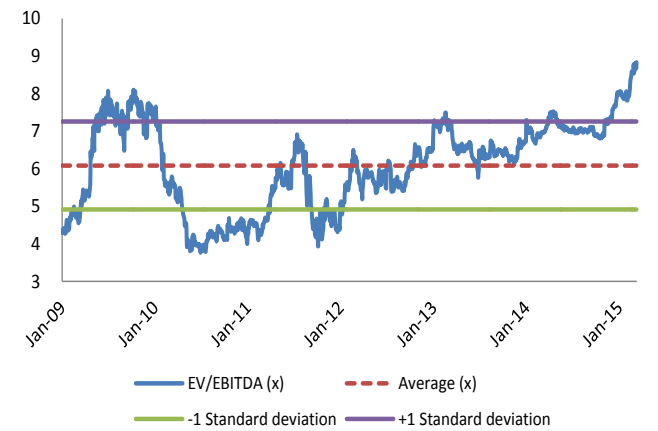
Sources: Bloomberg, CGIHK Research

Figure 4: Shanshui Cement Rolling Forward PBR Range



Sources: Bloomberg, CGIHK Research

Figure 5: Shanshui Cement EV/EBITDA Range



Sources: Bloomberg, CGIHK Research

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Explanation on Equity Ratings

BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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