

JPM-pp1

Asia Pacific Equity Research

24 March 2015

Anhui Conch - H (914 HK)

Overweight

Price: HK\$27.70

20 Mar 2015

Price Target: HK\$33.00

PT End Date: 31 Dec 2015

First take 2014 results - Miss, dividend hike a positive surprise

Anhui Conch (Conch)'s 2014 results missed expectations but sharply higher dividends (+86% y/y) declared should cushion the disappointment, in our view. For 2015, the company is targeting robust volume growth of 12% y/y and expects costs to remain contained. Armed with a strong balance sheet and solid free cash generation, we view Conch as strongly positioned for the current market downturn and a beneficiary of China's infrastructure stimulus initiatives. Reiterate OW rating.

Results Highlights

- **2014 results miss; higher dividend payout.** Conch announced 2014 net profit of RMB11.0Bn (+17% y/y, consensus RMB11.5B, JPM RMB11.9B). In our view, the key factors driving the earnings miss included:- a) lower-than-expected sales volume of 249Mt (versus guidance of 256Mt) and b) higher-than-expected SG&A (+7 y/y). These offset savings from a) better-than-expected unit cost of RMB155/t (-2% y/y) and b) lower-than-expected income tax. Pleasingly, Conch lifted its payout ratio to 31% (2013: 20%), delivering DPS of RMB0.65/share, +86% (RMB0.35/share in 2013). With powerful FCF performance of RMB10.7Bn pushing net gearing (ND/E) lower to 8.3% at end-2014 (2013: 18.6%), we see scope for higher dividend distribution.
- **Guidance for 12% sales volume increase.** For 2015, Conch targets a 30Mt (12% y/y) growth in sales volume of cement and clinker, leaving 2015 total shipment at 279Mt. Capex of RMB9.0Bn has been slated for new plant development in China (Tongren, Linxia) and also overseas (Indonesia and Burma), which is expected to bring total capacity of clinker to 224Mt (+5% y/y) and cement to 285Mt (8% y/y) by end-2015. The company pushed ahead with M&A, acquiring 5 domestic companies in Hunan, Guizhou and Yunnan in 2014, strengthening its market leadership in South and Southwest China.
- **Constructive market outlook.** Conch provided an upbeat assessment of domestic cement markets, noting that while slower economic growth and fixed asset investment will place downward pressure on demand, China's robust infrastructure spending on railway, highways, affordable housing etc, along with national strategy of "One Belt and One Road", and "Yangtze River Economic Belt" to drive demand growth. On the supply side, restraint is likely due to new capacity control, elimination of backward capacity, higher emission standards and abolition of PC32.5 cement is expected to continue to improve industry concentration and supply/demand dynamic. This is in-line with our forecast that slowing capacity (net growth +0.5%) will trail behind demand growth (+2%), helping utilization rates lift higher and maintain industry margins.

Stock Impact

We expect any earnings disappointment to be muted by the positive surprise from the dividend hike and robust volume growth outlook.

Investor Briefing

Date: Wednesday, 25 March 2015

Time: 4:15 pm

Venue: Salon 4, Ballroom, 3/F, JW Marriott Hotel Hong Kong Pacific Place, 88 Queensway, Hong Kong

Language: Mandarin

Table 1: Anhui Conch FY2014 results under IFRS

Profit & loss (Rmb Mils)	1H12	2H12	2012	1H13	2H13	2013	1H14	2H14	2014	H/H% 2H14	Y/Y% 2H14	Y/Y% 2014
w	20,559	25,207	45,766	23,587	31,675	55,262	28,784	31,974	60,759	11%	1%	10%
Cost of sales	-15,103	-18,161	-33,265	-17,023	-20,252	-37,275	-18,599	-21,961	-40,560	-18%	-8%	-9%
Gross profit	5,456	7,046	12,502	6,564	11,423	17,987	10,185	10,013	20,198	-2%	-12%	12%
Other revenue	601	573	1,173	501	596	1,097	651	817	1,468	25%	37%	34%
Other net income	2	66	68	26	-4	21	8	-25	-17	nm	-470%	nm
Selling and	-963	-1,317	-2,280	-1,209	-1,475	-2,685	-1,319	-1,617	-2,937	-23%	-10%	-9%
Admin expenses	-892	-1,287	-2,178	-1,164	-1,399	-2,563	-1,085	-1,602	-2,687	-48%	-15%	-5%
EBIT	4,204	5,082	9,285	4,717	9,140	13,857	8,440	7,585	16,025	-10%	-17%	16%
D&A	1,545	-4,821	-3,276	-1,752	-1,822	-3,574	-1,900	-1,927	-3,828	-1%	-6%	-7%
EBITDA	2,658	9,903	12,561	6,469	10,962	17,431	10,341	9,513	19,853	-8%	-13%	14%
Finance costs	-532	-605	-1,137	-594	-566	-1,161	-547	-492	-1,039	10%	13%	10%
Profits (losses) from asso	-2	-3	-5	-23	24	0	-26	-29	-55	-15%	nm	nm
Profits (losses) from JV	-6	-12	-18	-19	-7	-26	-1	-3	-4	-264%	54%	84%
Pretax profit	3,664	4,462	8,126	4,081	8,591	12,671	7,866	7,061	14,927	-10%	-18%	18%
Income tax	-678	-961	-1,639	-912	-1,938	-2,850	-1,742	-1,618	-3,360	7%	17%	-18%
Minorities	-53	-103	-156	-110	-322	-432	-314	-272	-586	13%	15%	-36%
Net profit	2,933	3,398	6,331	3,059	6,331	9,389	5,811	5,170	10,981	-11%	-18%	17%
Extraordinary items	313	343	656	280	148	428	268	338	606			

Core profit	2,620	3,055	5,675	2,779	6,183	8,962	5,543	4,832	10,375	-13%	-22%	16%
Dividends	0	1,325	1,325	0	1,855	1,855	0	3,445	3,445			86%
Per share data												
EPS, diluted (Rmb/sh)	0.55	0.64	1.19	0.58	1.19	1.77	1.10	0.98	2.07	-11%	-18%	17%
Core EPS, diluted (Rmb/sh)	0.49	0.58	1.07	0.52	1.17	1.69	1.05	0.91	1.96	-13%	-22%	16%
DPS (Rmb/sh)	0.00	0.25	0.25	0.00	0.35	0.35	0.00	0.65	0.65			86%
Margin												
Gross Profit	27%	28%	27%	28%	36%	33%	35%	31%	33%	-4pps	-5pps	1pps
EBIT	20%	20%	20%	20%	29%	25%	29%	24%	26%	-6pps	-5pps	1pps
Net Income	14%	13%	14%	13%	20%	17%	20%	16%	18%	-4pps	-4pps	1pps
Tax rate	19%	22%	20%	22%	23%	22%	22%	23%	23%	1pps	0pps	0pps
Payout ratio			21%			20%			31%			12pps
Cash flow analysis												
Operating cash flow	6,033	4,303	10,336	5,682	9,517	15,199	8,154	9,500	17,654	17%	0%	16%
Investing cash flow	-5,687	-2,783	-8,470	-3,441	-9,035	-12,476	-2,873	-1,978	-4,851	31%	78%	61%
Capex	-4,305	-1,852	-6,157	-3,311	-4,194	-7,505	-3,414	-3,560	-6,974	-4%	15%	7%
FCF	1,728	2,451	4,179	2,371	5,323	7,694	4,740	5,941	10,681	25%	12%	39%
Ratio												
Net Debt/Equity	35.2%	30.3%	30.3%	27.6%	18.6%	18.6%	15.9%	8.3%	8.3%	-8pps	-10pps	-10pps
Current Ratio	1.1	1.6	1.6	1.5	1.7	1.7	1.8	1.8	1.8	-1%	2%	2%
Quick Ratio	0.8	1.3	1.3	1.2	1.5	1.5	1.4	1.5	1.5	4%	-1%	-1%
Inventory T/O Days	58.3	40.6	44.3	43.5	33.3	36.2	46.9	36.4	39.4	-23%	9%	9%
AR T/O Days	51.6	60.7	66.9	42.3	43.4	49.7	31.3	24.1	25.3	-23%	-44%	-49%
AP T/O Days	58.0	51.6	56.3	39.7	34.2	37.1	40.1	33.4	36.1	-17%	-2%	-3%
Conversion Cycle	51.8	49.7	54.9	46.0	42.5	48.7	38.1	27.1	28.6	-29%	-36%	-41%
ROA	6%	7%	6%	6%	13%	10%	12%	9%	10%	-2pps	-4pps	1pps
ROE	12%	13%	12%	11%	22%	16%	19%	15%	16%	-4pps	-7pps	0pps

Source: Company reports, J.P. Morgan

Table 2: Anhui Conch FY2014 results under PRC GAAP

Income Statement (Rmb Mn)	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	HoH 2H14	YoY 2H14	YoY 2014
Revenue	9,906	13,681	13,421	18,254	55,262	12,630	16,155	14,890	17,084	60,759	11%	1%	10%
Cost of sales	-7,428	-9,496	-8,970	-11,124	-37,018	-8,132	-10,340	-10,443	-11,349	-40,264	18%	8%	9%
Gross profit	2,478	4,185	4,451	7,130	18,244	4,498	5,814	4,447	5,735	20,494	-1%	-12%	12%
Tax surcharges	-46	-73	-70	-108	-297	-58	-90	-82	-110	-340	29%	8%	15%
Selling expenses	-555	-655	-663	-812	-2,685	-558	-761	-683	-934	-2,937	23%	10%	9%
Admin expenses	-485	-516	-545	-850	-2,396	-549	-532	-665	-933	-2,680	48%	15%	12%
Impairment loss	0	-160	0	0	-161	0	0	0	1	1	876%	nm	nm
Changes in FV	3	11	-3	-3	8	-1	0	4	19	21	nm	nm	167%
Investment income	-7	-12	13	3	-3	11	-37	16	-11	-21	nm	-75%	711%
OP before interest	1,387	2,781	3,183	5,361	12,711	3,342	4,394	3,036	3,766	14,538	-12%	-20%	14%
Non OP income	174	258	259	223	914	186	301	307	280	1,074	21%	22%	18%
Non OPexpenses	-3	-3	-4	-15	-25	-3	-4	-2	-6	-15	1%	-61%	-41%
EBIT	1,558	3,035	3,438	5,569	13,600	3,525	4,691	3,341	4,040	15,597	-10%	-18%	15%
Financial costs	-274	-258	-206	-230	-969	-196	-174	-120	-223	-714	-7%	-21%	-26%
PBT	1,283	2,777	3,232	5,338	12,631	3,329	4,516	3,221	3,817	14,883	-10%	-18%	18%
less: income tax	-283	-608	-761	-1,168	-2,820	-740	-962	-696	-897	-3,295	-6%	-17%	17%
PAT	1,001	2,169	2,471	4,170	9,811	2,589	3,554	2,525	2,919	11,588	-11%	-18%	18%
Minorities	-29	-82	-147	-174	-431	-115	-206	-174	-99	-595	-15%	-15%	38%
Net Income	972	2,088	2,324	3,996	9,380	2,473	3,348	2,352	2,820	10,993	-11%	-18%	17%
Basic EPS	0.18	0.40	0.44	0.75	1.77	0.47	0.63	0.44	0.53	2.07	-12%	-18%	17%
Diluted EPS	0.18	0.40	0.44	0.75	1.77	0.47	0.63	0.44	0.53	2.07	-12%	-18%	17%
Cash flow analysis													
Operating cash flow	2,562	3,793	3,763	5,081	15,199	3,019	5,135	4,976	4,525	17,654	17%	7%	16%
Investing cash flow	-1,192	-2,249	-4,978	-4,057	-12,476	-2,179	-693	-556	-1,423	-4,851	-31%	-78%	-61%
Capex	-1,472	-1,839	-1,687	-2,563	-7,562	-2,184	-1,230	-1,596	-1,963	-6,974	4%	-16%	-8%
FCF	1,090	1,953	2,076	2,517	7,637	835	3,905	3,379	2,562	10,681	25%	29%	40%
Margin													
Gross profit margin	25%	31%	33%	39%	33%	36%	36%	30%	34%	34%	-4pps	-5pps	1pps
EBIT Margin	16%	22%	26%	31%	25%	28%	29%	22%	24%	26%	-5pps	-5pps	1pps
Core income margin	10%	15%	17%	22%	17%	20%	21%	16%	17%	18%	-4pps	-4pps	1pps
Tax rate	22%	22%	24%	22%	22%	22%	21%	22%	24%	22%	1pps	0pps	0pps
Volume													
Cement & clinker (Mt)	46	57	63	63	228	48	66	68	68	249			
Implied ASP (RMB/t)	214	241	215	292	242	263	245	221	253	244	18%	8%	9%
GP per ton (RMB/t)	54	74	71	114	80	94	88	66	85	82	-17%	-19%	3%
Unit cost (RMB/t)	160	167	144	178	162	170	157	155	168	162	0%	0%	0%
NP per ton (RMB/t)	21	37	37	64	41	52	51	35	42	44	-25%	-24%	7%

Source: Company Reports, J.P. Morgan

Investment Thesis

Anhui Conch is the second-largest cement producer in China (after CNBM), with total cement capacity of 231Mt (vs CNBM: 380Mt) at end-2013. With nearly

80% of the company's capacity located in the Eastern and Southern regions, Conch is well positioned to leverage tighter markets and higher utilization levels in coming years, in our view. Looking forward, policy measures to support urbanization and reduce capacity set the stage for improved utilization rates. Stay OW.

Valuation

Our Dec-15 PT of HK\$33.00 is based on a blended average of: 1) P/B-ROE valuation (HK\$32.90), based on a 1.9x P/BV; 2) HK\$37.40 using an 7.7x EV/EBITDA multiple; 3) HK\$37.60 using a five-year average P/E multiple of 11.9x; and 4) a DCF-based NPV of HK\$28.60. This equates to a 10.5x FY15E P/E and 1.9x P/BV, below the historical means (P/E of 11.9x, P/BV of 2.0x).

Risks to Rating and Price Target

The key risks to our rating and price target include:

- Fluctuations in the cement/clinker prices that are materially above or below our existing forecasts, given that Conch, as a pure cement play, derives all of its earnings from the production and sale of cement and clinker.
- On the raw materials side, movements in coal price and power tariffs provide earnings risks. These cost items combined account for over 60% of its total production cost.
- Slower-than-expected additions in cement capacity may affect volume growth while Conch is constructing 10 production lines domestically and in Indonesia.
- Conch has expressed a new focus on M&A. M&A transaction price/size may pose an upside/downside risk.
- Regulatory risk as high environmental awareness may raise capex requirement and eliminate obsolete capacity. Also, 5-10% of Conch's earnings come from government subsidies. Any change in government tax policy may impact earnings adversely.
- Conch's share price movements have historically correlated more strongly with the Hang Seng Index.

Asia Metals and Mining

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Date	Rating	Share Price (HK\$)	Price Target (HK \$)
17-Jul-08	N	16.25	15.00
05-Sep-08	N	11.55	12.66
17-Oct-08	N	8.33	8.00
13-Nov-08	N	10.30	10.00
07-Jan-09	UW	13.53	10.00
03-Mar-09	UW	11.47	9.33
15-May-09	OW	17.63	23.33
12-Mar-10	N	16.95	19.33

<http://gps-app.emea.jpmmchase.net:6080/server/console/chart/?shareClassId=503703&shareClassServerId=4&chartDesignation=1&actionType=C>

26-Oct-10	N	22.87	23.33
12-Jan-11	OW	24.87	30.66
07-Apr-11	OW	31.47	47.00
22-Sep-11	OW	23.05	40.00
14-Oct-11	OW	26.15	34.00
16-Feb-12	OW	26.95	32.00
18-Apr-12	OW	24.70	30.00
20-Apr-12	OW	25.20	28.00
08-Jul-12	OW	21.10	25.00
24-Oct-12	OW	25.85	30.00
23-Mar-13	OW	26.15	32.00
18-Oct-13	NR	26.90	--
11-Dec-13	OW	30.05	35.00
25-Mar-14	OW	30.65	38.00
27-Aug-14	OW	28.75	36.00
03-Mar-15	OW	26.25	33.00

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IB clients*	75%	67%	52%

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