

JPM-pp1

Asia Pacific Equity Research

25 March 2015

# China National Building Material (3323 HK)

Overweight

Price: HK\$7.58

20 Mar 2015

Price Target: HK\$9.00

PT End Date: 31 Dec 2015

First take FY2014 results - In line; deleveraging story continues

China National Building Material (CNBM) reported solid 2014 numbers with net profit (NP) of Rmb5.9B (+3% y/y) in-line with expectations. Key highlights were its record high 4Q14 GP/t, a significant fall in net gearing levels and management's upbeat assessment of cement market, despite weak shipment data. Trading at c5x FY15 PE (versus peers at 8.0x), we view CNBM as a cheap proxy to rising infrastructure activity, 2Q seasonal recovery in cement markets and a beneficiary of SOE reform in the long term. Stay OW rated.

## Key highlights

- **2014 result in-line.** CNBM reported 2014 net profit of RMB5.9Bn (+3% y/y), in line with ours and the Street estimates. 4Q net profit was sequentially higher at RMB2.3Bn (+23% q/q), thanks to higher ASP (+20% q/q) and flat unit cost which lifted GP/t to a record level of RMB96/t (+93% q/q). For 2014, CNBM's total shipment of cement/clinker was 289Mt (+2% y/y) and concrete was 85M m3 – both falling short of CNBM's targets of 325Mt and 105M m3, but higher GP/t of RMB71/t (+9% y/y) was in-line with our expectations.
- **De-leveraging continues.** Net gearing (ND/E) of 249% at end-2014 met CNBM's deleverage target of c250% set early last year. This however was helped by RMB5b worth of perpetual bonds. By transferring this amount to debt, we estimate overall pro-forma ND/E still improved to 277% (2013: 301%).
- **Upbeat outlook guidance.** While no specific operating targets for 2015 were given, CNBM provided a positive assessment of cement markets, noting that China's ongoing urbanization and robust demand from infrastructure (roads, railway, water conservancy) and real estate will sustain cement consumption at c2.5Bt levels. Meanwhile, slower capacity addition of 40Mt and policy support such as elimination of c100Mt of cement capacity, higher product (abolishment of PC32.5) and environmental protection standards should see better industry concentration.

## Stock Impact

- We expect CNBM's 2014 results to be well received given continued deleveraging

## Investor Briefing

Date: 25 March 2015 (Wednesday)

Time: 3:15p.m. – 4:15p.m.

Venue: Ballroom B, 5/F, Island Shangri-la, Pacific Place, Supreme Court Road, Central, Hong Kong

Medium: Mandarin

Table 1: CNBM 3Q14 quarterly results (IFRS)

Profit & Loss RMB million	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	QoQ% 4Q14	YoY% 4Q14	YoY% 2014
Turnover	19,798	30,734	31,635	35,521	117,688	22,125	33,655	32,702	33,529	122,011	3%	-6%	4%
Cost of sales	-15,929	-23,004	-22,761	-25,855	-87,550	-16,698	-24,185	-23,882	-23,967	-88,732	0%	7%	-1%
<b>Gross profit</b>	<b>3,868</b>	<b>7,729</b>	<b>8,874</b>	<b>9,666</b>	<b>30,138</b>	<b>5,427</b>	<b>9,471</b>	<b>8,820</b>	<b>9,562</b>	<b>33,279</b>	8%	-1%	10%
Selling costs	-723	-1,749	-1,543	-2,914	-6,928	-962	-2,042	-1,527	-3,230	-7,760	-112%	-11%	-12%
Admin expenses	-1,072	-2,541	-1,444	-3,077	-8,135	-1,303	-3,126	-1,278	-3,342	-9,049	-161%	-9%	-11%
Other revenue	507	1,021	100	2,577	4,204	371	1,282	200	3,102	4,955	1449%	20%	18%
Other expenses	-32	32	-253	253	0	-66	66	-440	440	0	nm	74%	nm
<b>EBIT</b>	<b>2,548</b>	<b>4,493</b>	<b>5,734</b>	<b>6,504</b>	<b>19,279</b>	<b>3,467</b>	<b>5,650</b>	<b>5,775</b>	<b>6,532</b>	<b>21,424</b>	13%	0%	11%
D&A	1,509	1,509	1,509	1,205	5,733	1,433	1,985	1,985	-12,512	-7,108	nm	nm	nm
<b>EBITDA</b>	<b>4,058</b>	<b>6,002</b>	<b>7,243</b>	<b>7,709</b>	<b>25,012</b>	<b>4,900</b>	<b>7,635</b>	<b>7,760</b>	<b>-5,979</b>	<b>14,316</b>	nm	nm	-43%
Finance costs	-1,879	-2,440	-2,621	-2,367	-9,307	-2,491	-2,906	-2,709	-2,750	-10,857	-2%	-16%	-17%
Profits (L) from asso	72	71	259	229	631	106	226	210	443	985	110%	93%	56%
Profits (L) from JV	0	0	0	0	0	0	0	0	0	0	nm	nm	nm
<b>Pretax profit</b>	<b>741</b>	<b>2,124</b>	<b>3,372</b>	<b>4,366</b>	<b>10,603</b>	<b>1,082</b>	<b>2,970</b>	<b>3,276</b>	<b>4,225</b>	<b>11,553</b>	29%	-3%	9%
Income tax	-236	-584	-607	-863	-2,291	-291	-884	-637	-1,071	-2,881	-68%	-24%	-26%
Minorities	-193	-499	-819	-1,039	-2,550	-236	-845	-790	-882	-2,752	-12%	15%	-8%
<b>Net profit</b>	<b>312</b>	<b>1,041</b>	<b>1,945</b>	<b>2,464</b>	<b>5,762</b>	<b>556</b>	<b>1,242</b>	<b>1,849</b>	<b>2,272</b>	<b>5,920</b>	23%	-8%	3%
Dividends					864					891			3%
EPS, basic (Rmb/ sh)	0.06	0.19	0.36	0.46	1.07	0.10	0.23	0.34	0.42	1.10	23%	-8%	3%
DPS (Rmb/sh)					0.16					0.16			3%

<b>Margins</b>													
Gross margin	19.5%	25.1%	28.1%	27.2%	25.6%	24.5%	28.1%	27.0%	28.5%	27.3%	2pps	1pps	2pps
EBITDA margin	20.5%	19.5%	22.9%	21.7%	21.3%	22.1%	22.7%	23.7%	-17.8%	11.7%	-42pps	-40pps	-10pps
EBIT Margin	12.9%	14.6%	18.1%	18.3%	16.4%	15.7%	16.8%	17.7%	19.5%	17.6%	2pps	1pps	1pps
Net margin	1.6%	3.4%	6.1%	6.9%	4.9%	2.5%	3.7%	5.7%	6.8%	4.9%	1pps	0pps	0pps
Tax rate	31.9%	27.5%	18.0%	19.8%	21.6%	26.8%	29.7%	19.4%	25.3%	24.9%	6pps	6pps	3pps
Payout ratio					15%					15%			0pps
<b>Cash flow analysis</b>													
Operating CF	2,135	2,433	2,469	4,619	11,657	2,461	5,025	4,441	3,242	15,169	-27%	-30%	30%
Investment CF	-6,267	-14,304	-3,192	-4,723	-28,487	-4,185	-3,629	-2,024	-7,060	-16,898	-249%	-49%	41%
Capex	-2,089	-3,618	-2,858	106	-8,459	-2,485	-1,764	-1,929	-3,171	-9,348	-64%	nm	-11%
FCF	46	-1,185	-389	4,725	3,198	-23	3,261	2,512	71	5,821	-97%	-99%	82%
<b>Ratios</b>													
Net Debt/Equity	314%	334%	324%	301%	301%	294%	301%	273%	249%	249%	-24pps	-52pps	-52pps
Current Ratio	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.6	0.5	0.5	-6%	4%	4%
Quick Ratio	0.5	0.5	0.5	0.4	0.4	0.5	0.4	0.5	0.5	0.5	-7%	6%	6%
Inventory T/O													
Days	76	57	57	52	61	85	62	63	63	69	0%	22%	12%
AR T/O Days	121	144	92	134	162	115	156	87	166	182	90%	24%	13%
AP T/O Days	127	178	102	171	201	272	210	207	195	211	-6%	14%	5%
Conversion Cycle	70	22	47	16	22	-71	9	-56	34	40	nm	120%	83%
ROE	4%	13%	24%	28%	16%	6%	14%	19%	22%	15%	3pps	-5pps	-2pps
ROA	4%	7%	8%	9%	7%	5%	7%	7%	8%	7%	1pps	-1pps	0pps

Source: Company data, J.P. Morgan,

Table 2: CNBM FY14 operating data

<b>OP data</b>											<b>QoQ%</b>	<b>YoY%</b>	<b>YoY%</b>
Year end December 31	<b>1Q13</b>	<b>2Q13</b>	<b>3Q13</b>	<b>4Q13</b>	<b>2013</b>	<b>1Q14</b>	<b>2Q14</b>	<b>3Q14</b>	<b>4Q14</b>	<b>2014</b>	<b>4Q14</b>	<b>4Q14</b>	<b>2014</b>
<b>Sales Volume</b>													
Cement (Mt)	48	48	58	67	222	49	56	64	65	234	2%	-4%	5%
Clincker (Mt)	14	14	16	18	61	0	28	17	11	56	-36%	-39%	-9%
<b>Cement and clincker (Mt)</b>	<b>62</b>	<b>62</b>	<b>75</b>	<b>85</b>	<b>283</b>	<b>49</b>	<b>84</b>	<b>75</b>	<b>76</b>	<b>289</b>	<b>0%</b>	<b>-11%</b>	<b>2%</b>
--China United	15	15	16	21	67	10	21	19	18	68	-2%	-12%	1%
--South Cement	26	26	30	36	119	21	34	30	32	117	8%	-12%	-2%
--North Cement	4	4	8	5	21	1	7	8	6	23	-31%	19%	7%
--Southwest Cement	16	16	19	24	76	17	22	17	26	82	50%	8%	8%
<b>Concrete sales volume</b>	<b>n.a</b>	<b>35</b>	<b>23</b>	<b>28</b>	<b>85</b>	<b>15</b>	<b>26</b>	<b>23</b>	<b>23</b>	<b>85</b>	<b>1%</b>	<b>-17%</b>	<b>0%</b>
--China United	n.a	13	9	11	33	6	11	9	9	35	4%	-17%	6%
--South Cement	n.a	21	13	15	49	9	14	11	13	46	17%	-16%	-6%
--North Cement	n.a	0	0	1	1	0	1	1	1	2	-43%	-10%	58%
--Southwest Cement	n.a	0	0	0	1	0	0	0	0	1	-24%	-31%	4%
<b>Cement and clinker</b>													
Revenue (RMBmn)	n.a	30,495	18,599	22,437	71,531	12,770	21,279	17,685	21,300	73,034	20%	-5%	2%
Cost of sales (RMBmn)	n.a	23,498	13,220	16,436	53,154	9,372	15,307	13,924	14,000	52,603	1%	-15%	-1%
Gross profit (RMBmn)	n.a	6,997	5,379	6,001	18,377	3,398	5,972	3,762	7,300	20,431	94%	22%	11%
<b>GP per ton (RMB)</b>													
<b>CNBM</b>	<b>57</b>	<b>57</b>	<b>72</b>	<b>71</b>	<b>65</b>	<b>69</b>	<b>71</b>	<b>50</b>	<b>96</b>	<b>71</b>	<b>93%</b>	<b>37%</b>	<b>9%</b>
China United	48	48	68	63	57	68	74	53	65	65	22%	4%	13%
South Cement	48	48	62	61	55	69	51	41	83	60	102%	35%	9%
North Cement	91	91	113	108	103	96	106	55	151	98	174%	40%	-5%
Southwest Cement	70	70	78	81	75	69	87	63	99	82	57%	22%	9%
<b>Unit cost (RMB/t)</b>													
<b>CNBM</b>	<b>190</b>	<b>190</b>	<b>177</b>	<b>193</b>	<b>188</b>	<b>191</b>	<b>182</b>	<b>185</b>	<b>185</b>	<b>182</b>	<b>0%</b>	<b>-4%</b>	<b>-3%</b>
China United	190	190	170	194	186	190	178	185	183	183	-1%	-6%	-2%
South Cement	193	193	177	191	188	197	186	181	169	182	-7%	-12%	-3%
North Cement	227	227	211	217	219	207	197	240	199	214	-17%	-8%	-2%
Southwest Cement	178	178	177	183	180	184	173	178	157	171	-12%	-14%	-5%
											nm	nm	nm
<b>ASP per ton (RMB/t)</b>													
<b>CNBM</b>	<b>247</b>	<b>247</b>	<b>249</b>	<b>264</b>	<b>253</b>	<b>261</b>	<b>253</b>	<b>235</b>	<b>281</b>	<b>252</b>	<b>20%</b>	<b>7%</b>	<b>0%</b>
China United	238	238	238	257	244	258	252	238	249	248	4%	-3%	2%
South Cement	240	240	239	252	244	266	237	222	251	242	13%	0%	-1%
North Cement	318	318	324	325	322	303	303	295	350	312	19%	8%	-3%
Southwest Cement	249	249	255	264	255	253	260	241	256	253	6%	-3%	-1%
<b>Commercial concrete</b>													
Revenue (RMBmn)	n.a	n.a	6,874	9,284	26,593	4,635	8,447	6,997	7,928	28,007	13%	-15%	5%
COGS (RMBmn)	n.a	n.a	4,931	6,695	19,081	3,628	6,052	3,698	6,351	19,730	72%	-5%	3%
Gross profit (RMBmn)	n.a	n.a	1,943	2,590	7,512	1,007	2,395	3,298	1,577	8,277	-52%	-39%	10%

**Gross profit per m3****(RMB)**

CNBM	86	86	86	93	88	69	84	144	68	97	-53%	-27%	10%
China United	86	86	96	87	89	64	81	144	70	94	-51%	-20%	6%
South Cement	87	87	77	100	88	73	85	173	62	99	-64%	-38%	13%
North Cement	96	96	141	110	116	109	132	85	203	129	138%	85%	12%
Southwest Cement	29	29	103	-19	36	61	90	2	21	53	787%	Nm	46%

Source: Company data, J.P. Morgan,

**Investment Thesis**

We have an OW rating on China National Building Material (CNBM). A strategy of acquiring growth via M&A and local market concentration has now transitioned into a more mature focus on improving earnings quality and optimising its existing portfolio. With positive FCF forecast to reduce the company's heavy debt burden sharply over coming years, we expect CNBM shares to continue to be re-rated.

**Valuation**

Our Dec-15 price target for CNBM of HK\$9.00 equates to 6.3x FY15E P/E (vs its five-year average of 6.8x) and 0.9x FY15E P/BV (vs its five-year average of 1.3x). This is based on a blended average of: 1) PB-ROE valuation (HK\$14.9) based on 1.4x PBV, 2) HK\$9.90, using the five-year average EV/EBITDA multiple of 8.5x,

3) HK\$10.50 using the five-year average P/E multiple of 6.8x, and 4) DCF-based NPV of HK\$8.20.

**Risks to Rating and Price Target**

The key risks for our CNBM price target include:

- Fluctuations in the cement/clinker prices that are materially above or below our existing forecasts, given that CNBM's earnings are largely dependent on the clinker/cement division, which accounts for over 90% of CNBM's revenue and 80% of gross profits.
- 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 CNBM may take time to reconcile the newly acquired, non-performing assets.
- Interest rate risk affects CNBM's earnings given its significant financial leverage.
- M&A activity depending on transaction price, may pose an upside risk.
- Regulatory risk, as high environmental awareness may raise capex requirements and eliminate obsolete capacity. Also, a significant portion of CNBM's earnings come from government subsidies. Any change in government tax policy would likely impact earnings adversely.

**Asia Metals and Mining**

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
03-Mar-09	UW	4.45	3.75
23-Apr-09	N	7.50	7.00
15-May-09	OW	8.60	11.00
11-Mar-10	OW	7.40	10.00
09-Jul-10	N	6.11	7.00
01-Mar-11	N	9.56	8.50
28-Apr-11	OW	15.85	22.50
14-Oct-11	OW	8.35	15.00
16-Feb-12	OW	10.60	12.00
08-Jul-12	OW	8.37	10.50
31-Oct-12	OW	9.65	12.50
22-Mar-13	OW	10.96	14.50
29-Apr-13	N	9.64	10.00
24-Aug-13	N	7.19	8.00
18-Oct-13	NR	7.71	--
11-Dec-13	OW	8.63	12.00
27-Aug-14	OW	7.45	9.75
03-Mar-15	OW	7.61	9.00

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IB clients*	56%	49%	33%
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IB clients*	75%	67%	52%

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