

JPM-pp1

Asia Pacific Equity Research

27 March 2015

## China BlueChemical Ltd (3983 HK)

Overweight

Price: HK\$2.80

25 Mar 2015

Price Target: HK\$4.80

PT End Date: 31 Dec 2015

Special dividend; addressing growth outlook and operational risks

Despite China BlueChemical (CBC) having already announced a profit warning (see [note](#)), we expect these results to be taken positively by the market with the company proposing a special dividend. While we have concerns about the company's growth outlook with no new projects after the company's Huahe coal-based urea (trial output end March) and see natural gas supply availability risks at Fudao Phase-I (contract expiry Jan-16), we see the company's move to return more cash to shareholders as positive. We remain OW.

- **Earnings pre-announced; moving on post impairment:** Reported FY14 net profit at Rmb105mn was down 94% y/y (previously guided down 90-95% y/y) related to two write-offs: 1) Rmb1.16bn on its POM plant at Tianye due to continuous low prices/overcapacity; and 2) Rmb570mn impairment loss on its Yangpoquan Coal assets.
- **Maintaining absolute dividend; special dividend introduced:** CBC proposed an FY14 dividend at Rmb0.01 and introduced a special dividend of Rmb0.11 (the dividend was Rmb0.14 in FY13), significantly better than the consensus of Rmb0.033.
- **Mixed outlook – fertilizer price reform; limited methanol price upside:** CBC outlined a mixed picture for its key products. With the government having abolished the gap between high- and low-season tariffs, domestic fertilizer prices will be aligned with international prices. However, CBC stated that despite increased domestic demand for methanol, there is "limited room for price increase" as the market remains oversupplied. Managing natural gas availability at Fudao Phase-I and review of a feasibility report of Xinhua coal mine which is supplementary to the Huahe project and starting construction in 2H15 are some of the key tasks for the company this year.

Table 1: China BlueChemical's FY14 results

Rmb mn	2H13	1H14A	2H14A	y/y	h/h
<b>Revenue</b>	<b>5,502</b>	<b>5,264</b>	<b>5,533</b>	<b>1%</b>	<b>5%</b>
COGS	(3,880)	(3,859)	(4,252)	10%	10%
Selling & Distribution	(227)	(194)	(231)	2%	19%
Other Operating Expenses	(265)	(199)	(320)	21%	61%
<b>Operating Income</b>	<b>1,130</b>	<b>1,012</b>	<b>730</b>	<b>(35%)</b>	<b>(28%)</b>
Finance & Other	(105)	(290)	(1,339)		
<b>Pre-tax profit</b>	<b>1,025</b>	<b>722</b>	<b>(609)</b>	<b>(159%)</b>	<b>(184%)</b>
Taxes	(269)	(195)	179		
Tax Rate, %	26%	27%	29%		
MI	(67)	(80)	88		
<b>Adj. net income</b>	<b>689</b>	<b>448</b>	<b>(342)</b>	<b>(150%)</b>	<b>(176%)</b>

Source: Company data, J.P. Morgan calculations.

## Investment Thesis

China BlueChemical (CBC) is one of the largest urea and methanol producers in China. Being natural gas-based with long-term contracts from sister company CNOOC Ltd, CBC enjoys relatively stable operating costs. CBC is diversifying into coal-based urea with a 520k ton/yr urea plant at Hegang. CBC has 1.8 mn ton/yr of urea production capacity in two locations in addition to 1.6 mn ton/yr of Methanol capacity. MAP/DAP capacity is 1 mn ton/yr with integration into phosphate mines. Our positive view of the shares is based on:

- **Growing domestic demand for fertilizers** – China has c20% of the world's population but only 9% of world's arable land, with available arable land decreasing; additionally, urbanization increases food demand. Both factors lead to the need to raise crop yields hence more fertilizer demand. Similar factors are seen in India, CBC's main export market for urea.
- **Growth of methanol demand** – Chinese demand for methanol is expected to grow at a c13% CAGR compared to global average growth of c9%.

- **More resilient than traditional petrochemicals** – Petrochemicals typically suffer during cyclical downturns; food demand and fertilizer demand tend to be more resilient through economic cycles.
- **Strong financial position** – CBC is net cash, offering a c4% dividend yield and has one of the highest FCF yields at c6% within JPM's global fertilizer coverage.
- **Move to coal to sustain competitive growth** – CBC is moving to coal to support organic growth at a similar cash cost at existing natural gas plants, which we believe will sustain high returns. Shifting to an integrated model with a new coal-based urea plant in Hegang coming online in 4Q14 and a shift to coal at its Tianye facilities offer a c20-30% cost benefit over the current natural gas feedstock.

## Valuation

Our PT of HK\$4.8 (Dec-15, DCF-based) is based on a DCF valuation and implies 2015E P/E of 10.6x and P/BV of 1.1x. Our terminal growth rate is 1.6% and our WACC is 11.3%.

## Risks to Rating and Price Target

Key downside risks to our PT are lower urea/methanol prices, and larger-than-expected gas price hikes.

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Date	Rating	Share Price (HK\$)	Price Target (HK \$)
19-Jun-07	N	4.42	4.00
27-Aug-07	N	4.28	4.40
31-Mar-08	OW	4.32	5.20
28-Aug-08	OW	4.86	5.70
17-Dec-09	OW	4.43	5.30
13-Jan-11	OW	5.93	7.30
08-Nov-11	OW	6.48	7.60
12-Jun-13	NR	4.94	--
24-Aug-13	OW	4.06	5.30
28-Jan-14	OW	4.35	5.10
30-Jul-14	OW	4.08	4.90
31-Aug-14	OW	3.82	4.80

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