March 26, 2015

China National Building Material Company

Takeaways from Result Briefing and NDR

Industry View	Stock Rating
Cautious	**Equal-weight**

Management thinks that China cement demand has peaked and will remain at current levels while supply conditions improve. The company aims to further consolidate the industry through more equity investments in other producers.

What's new: CNBM held its result briefing and NDR in Hong Kong; key takeaways are as below:

Demand and Supply: Management sees demand reaching peak level at 2.5 billion tons in 2015 and remaining at this level in the next 10 years. They see 2015 as likely to be the first year with negative capacity growth and hence improved market balance.

Current business operation: 2M15 cement sales volume up 24% YoY, due to lower base last year. 2M15 ASP drop of Rmb30/t offset partially by decline in cost. The company expects prices to start recovering in mid-March. Current inventory is at mid-level.

Future strategy: The company says it will copy the Shanshui case in future strategy, to increase equity interests in major cement producers. They see this as an effective and cost efficient way to increase market share and pricing power. It has already made seven similar transactions.

2015 guidance: Cement sales volume at 310mnt, concrete sales volume at 100mn m^3, GP to be flat YoY, CAPEX at Rmb13bn, net gearing to be maintained at below 250% and finance cost to be reduced by Rmb1bn in 2015.

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China National Building Material Company (3323.HK , 3323 HK)

China Cement / China

Stock Rating	**Equal-weight**
Industry View	**Cautious**
Shr price, close (Mar 25, 2015)	HK$7.39
52-Week Range	HK$8.42-6.70
Sh out, dil, curr (mn)	5,399
Mkt cap, curr (mn)	Rmb31,918
EV, curr (mn)	Rmb192,687
Avg daily trading value (mn)	HK$167.22

Fiscal Year Ending	**12/13**	**12/14e**	**12/15e**	**12/16e**
ModelWare EPS (Rmb)	1.07	1.01	1.02	1.04
Consensus EPS (Rmb)§	1.06	1.04	1.06	1.06
Revenue, net (Rmb mn)	117,688	132,837	145,478	153,274
EBITDA (Rmb mn)	25,643	29,338	30,108	31,164
ModelWare net inc (Rmb mn)	5,762	5,471	5,515	5,614
P/E	6.1	6.0	5.8	5.7
P/BV	1.0	0.8	0.7	0.6
RNOA (%)	9.5	8.6	8.2	7.9
ROE (%)	18.9	15.5	13.7	12.4
EV/EBITDA	7.6	6.8	6.9	6.6
Div yld (%)	2.4	1.9	2.0	2.0
FCF yld ratio (%)	(29.2)	(19.8)	(24.7)	2.9
Leverage (EOP) (%)	427.5	383.9	352.6	309.1

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
§ = Consensus data is provided by Thomson Reuters Estimates
e = Morgan Stanley Research estimates

Detailed Takeaways

Demand: Management believes cement demand in 2015 will reach 2.5 billion tons, and sees this as the peak level which will persist for 10 years. For 2015, management is cautiously optimistic on demand: 1) Property market still remains weak, but the company expects it to recover in April as recent mortgage and HPR loosening all show that the government is willing to support the property market. 2) Investment will still be the main driver. 2015 FAI target is Rmb59 trillion, up from Rmb50.2 trillion in 2014. Property investment target at Rmb10.6 trillion (2014 actual: Rmb9.6 trillion). Social housing units target is 10.66mn units, after taking into account the 3.66mn units of rural housing refurbishment, which requires more cement than urban construction. Management sees cement prices picking up in 2H this year from a low opening at the beginning of 2015.

Industry:

Supply - 2015 to see first negative growth: In 2014, China added 70mnt clinker capacity (equivalent to 91mnt cement) and phased out 81mnt cement capacity. In 2015, management expects China to add 50mnt while phasing out 100mnt. Meanwhile, enforcement of new environmental standards will also curb capacity growth. In addition, the market's cautious outlook on demand will reduce producers' incentive to grow capacity.

Regional Market:

- **Northern China:** Showed worst performance in 2014. but the company expects it to perform better in 2015 due to solid winter production cut.
- **Eastern China:** Shandong will perform better in 2015 because of 60% market share controlled by CNBM and Shanshui. Yangtze River Delta region will improve as no new capacity addition and elimination is due ahead of national policy.
- **Western China:** More new supply is coming in this region such as Gansu, Qinghai, so fundamentals will be weaker in 2015. After the infrastructure construction peak, oversupply conditions will be worse, such as the previous case of Inner Mongolia.
- **Central China:** CNBM together with Tianrui and Tongli is trying to build a core profit region in Henan.
- **Southwest China:** Guizhou market is more consolidated. Its cement price has shown over Rmb50/t increase YoY. Yunnan is in weaker condition due to oversupply issue. Sichuan and Chongqing market will show better performance YoY. Capacity addition in Yunnan and Guizhou is higher so will face more pressure.
- **Overseas markets:** The company sees better opportunities overseas under current oversupply conditions in the domestic market.

Company:

2014 performance recap:

- Cement sales volume missed consensus but up 2.1% YoY. Concrete volume also missed due to poor property market.
- Cement GP/t at Rmb71, GP margin up 2 percentage points ("ppt") to 28.4%. Concrete GP at Rmb97/m^3, GPM up 1.4 ppt to 29.6%
- SG&A up Rmb3.3bn, which needs more work to control
- Profitability is lower than Conch but better than other materials SOEs. Net profit inline with guidance.
- 2014 Operating cash flow at Rmb15.2bn, up 30% YoY
- CAPEX over-spending is due to investment in Shanshui, which was not planned

- Net gearing is lowered to below 250% target through perpetual bonds issuance.
- Concrete AR days increased to 62% of sales by end of 2014 from 46% a year earlier.

Current operation: 2M15 cement sales volume up 24% YoY, due to lower base last year. GP/t is lower YoY as a result of Rmb30/t drop in ASP together with slight drop in cost. The company expects prices to start recovering in mid-March. Current inventory is at mid-level.

Future strategies and guidance:

2015 main strategies are: control capex to be within Rmb13bn, lower gearing to 200%, increase equity stakes in more cement producers but not purchase plants

Industry Consolidation:

- The company is not going to buy new plants, but will do more equity investments in cement producers because it's cheaper. They have already done seven transactions, including Shanshui, Tongli, Shangfeng, Jinfeng, Yatai, Shuangma (larfarge) etc.
- It will focus on areas where they have existing presence, to increase market share and pricing power, instead of entering new markets.
- Management expects China to need another 3-5 years to reach a more consolidated and healthier cement industry.
- China's cement industry consolidation level (top 10 clinker producers market share) has increased from 16% (2008) to 52% (2014), more supporting policies will come out at top level to incentivise more consolidation and reform.

Investment in Shanshui:

- Shanshui will be controlled by existing management, CNBM will have influence but not controlling power. It has no intention to do so.
- Shanshui, CNBM and Asia Cement are all very cooperative with each other with the same aim to increase Shanshui's profitability, they expect net profit to increase to Rmb2bn in medium to long term.
- Shanshui case will be copied in other regions and other companies.

SOE reform: Waiting for new policies to come out at the top level. China is aiming to make this market driven. The two A share subsidiaries will implement equity incentive programs and share buybacks. Management expects SOE reform to take time.

2015 guidance:

- **Cement sales volume:** 310mnt
- **Concrete sales volume:** 100mn m^3
- **GP** to be flat YoY
- **Capex**: Rmb13bn, of which Rmb4bn will be used to settle previous acquisition cost (total of Rmb10bn to be settled in three years), Rmb2bn planned for acquiring additional equity interests in other cement producers and Rmb7bn to be used for projects under construction which include seven cement lines at 2mnt/year capacity each (6x 5000t/d + 1x 2500t/d). These are scheduled for production between 2015 and 2016
- Gross interest bearing debt to reduce to below Rmb170bn in 2015, vs. Rmb176bn at end of 2014 and Rmb180bn by June 2014.
- Finance cost to be reduced by Rmb1bn in 2015 (Rmb0.8bn if not factoring in further rate cuts).

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Overweight/Buy	**1161**	**35%**	**321**	**41%**	**28%**
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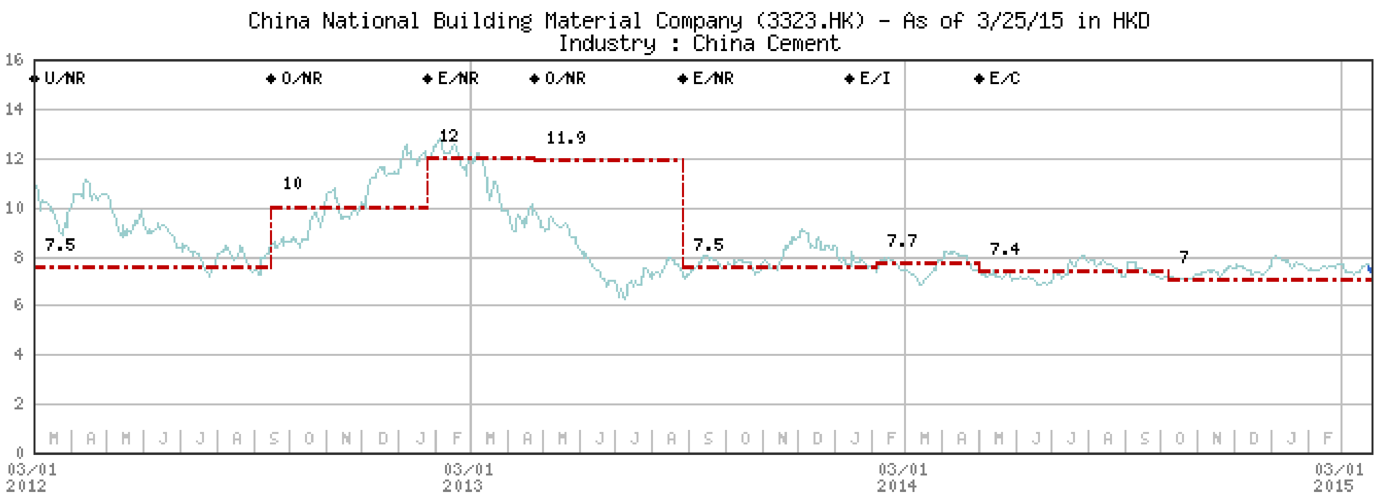
Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 3/1/12 : U/NR; 9/16/12 : O/NR; 1/24/13 : E/NR; 4/24/13 : O/NR; 8/26/13 : E/NR; 1/13/14 : E/I; 5/2/14 : E/C

Price Target History: 2/22/12 : 7.5; 9/16/12 : 10; 1/24/13 : 12; 4/24/13 : 11.9; 8/26/13 : 7.5; 2/5/14 : 7.7; 5/2/14 : 7.4; 10/8/14 : 7

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
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INDUSTRY COVERAGE: China Cement

COMPANY (TICKER)	RATING (AS OF)	PRICE* (03/25/2015)
Lam CFA, John		
Anhui Conch Cement Co. Ltd (0914.HK)	U (05/02/2014)	HK$27.75
Anhui Conch Cement Co. Ltd (600585.SS)	E (07/28/2014)	Rmb21.48
BBMG Corporation (601992.SS)	U (08/29/2014)	Rmb10.06
BBMG Corporation (2009.HK)	E (01/24/2013)	HK$6.58
China National Materials (Sinoma) (1893.HK)	U (09/03/2013)	HK$2.05
China Resources Cement Holdings Ltd. (1313.HK)	U (05/02/2014)	HK$4.27
China Shanshui Cement Group (0691.HK)	U (08/26/2013)	HK$5.74
Huaxin Cement Co (600801.SS)	O (12/10/2014)	Rmb10.64
West China Cement (2233.HK)	O (05/02/2014)	HK$1.14
Zhang, Rachel L		
China National Building Material Company (3323.HK)	E (08/26/2013)	HK$7.39

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