

Nat Resources & Energy
Energy Equipment
 Equity – China

Reduce

Target price (HKD)	15.00
Share price (HKD)	20.45
Upside/Downside (%)	-26.7

Performance	1M	3M	12M
Absolute (%)	1.2	32.3	17.7
Relative ^A (%)	5.4	10.9	-9.2

Index^A HSCEI

RIC 0586.HK
 Bloomberg 586 HK

Market cap (USDm) 4,759
 Market cap (HKDm) 36,907

Enterprise value (CNYm) 16430
 Free float (%) 37

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China Conch Venture (586 HK)

Downgrade to Reduce: Unattractive valuation

- ▶ **HSBC remains negative on Anhui Conch, which represents c70% of our valuation of CCV**
- ▶ **Ex-cement operations' valuation looks unattractive with possible selling pressure after share distribution**
- ▶ **Downgrade to Reduce (from Hold); TP at HKD15.00 (from HKD14.70)**

Remain negative on cement: HSBC remains negative on Anhui Conch (914 HK, Reduce, TP HKD25, covered by Wei Sim) on sluggish macro demand and oversupply. We calculate that Anhui Conch represents c70% of our revised valuation for China Conch Venture (CCV).

Unattractive valuation for ex-cement business: Stripping out cement, we calculate that its core operations are trading at a 33x PE on 2015e. We think the valuation looks unattractive to us as 1) a significant proportion of the earnings growth is driven by pure EPC earnings and 2) the valuation looks expensive compared to peers. Even within construction earnings in 2015, we expect c40% of them to be pure EPC earnings which are not going to be followed by operations income and which should be assigned much lower valuation multiple than 33x. In addition, other environmental peers are trading at 24x PE on average in 2015e, which is cheaper than CCV.

Downgrade to Reduce from Hold: We downgrade CCV to Reduce (from Hold) on HSBC's negative view on Anhui Conch, unattractive valuation for ex-cement operations and also possible share selling pressure from the recent share distribution. CCV recently announced that c60% of its shares previously held by trustee companies (representing employees) will be distributed to employees directly. This effectively removes the selling restrictions for employee shares and may put pressure on the share price. We think this is especially relevant given the share price rally with MSCI China inclusion.

We raise our earnings forecasts by 10% in 2015 and 6% in 2016 as we expect more waste incineration project wins on the back of the favourable outlook for China's environmental protection industry. Our earnings revisions are lower than our revenue revisions as our earnings forecasts on the associate income from cement, the biggest part of the bottom line, are unchanged. Our earnings forecasts are 7% below consensus in 2015-16 due to our negative views on cement.

Financials & valuation

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (CNYm)				
Revenue	1,748	3,284	3,143	2,905
EBITDA	616	931	1,030	882
Depreciation & amortisation	-55	-77	-82	-88
Operating profit/EBIT	560	854	948	794
Net interest	-61	-109	-179	-179
PBT	2,480	2,542	2,600	3,940
HSBC PBT	2,480	2,542	2,600	3,940
Taxation	-107	-171	-177	-154
Net profit	2,239	2,204	2,253	3,521
HSBC net profit	2,239	2,204	2,253	3,521

Cash flow summary (CNYm)

Cash flow from operations	337	-334	764	851
Capex	-318	-157	-169	-182
Cash flow from investment	-677	-2,580	-2,535	-2,552
Dividends	-357	-433	-451	-704
Change in net debt	852	1,634	545	-763
FCF equity	9	-575	442	513

Balance sheet summary (CNYm)

Intangible fixed assets	1	1	1	1
Tangible fixed assets	1,538	2,259	2,270	2,373
Current assets	4,000	8,067	7,343	7,862
Cash & others	2,058	3,797	3,252	4,015
Total assets	17,207	24,424	26,083	29,082
Operating liabilities	1,106	3,013	2,700	2,618
Gross debt	800	4,173	4,173	4,173
Net debt	-1,258	377	921	158
Shareholders funds	14,854	16,625	18,426	21,243
Invested capital	2,375	3,517	3,661	3,604

Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	9.8	87.9	-4.3	-7.6
EBITDA	43.3	51.2	10.7	-14.4
Operating profit	46.6	52.4	11.0	-16.2
PBT	20.9	2.5	2.3	51.6
HSBC EPS	21.9	-1.5	2.2	56.3

Ratios (%)

Revenue/IC (x)	0.7	0.9	0.9	0.8
ROIC	16.5	16.3	16.2	12.8
ROE	15.5	13.8	12.6	17.0
ROA	13.8	9.7	9.3	13.0
EBITDA margin	35.2	28.3	32.8	30.4
Operating profit margin	32.0	26.0	30.2	27.3
EBITDA/net interest (x)	10.1	8.5	5.8	4.9
Net debt/equity	-8.2	2.2	4.8	0.7
Net debt/EBITDA (x)	-2.0	0.4	0.9	0.2
CF from operations/net debt			82.9	537.7

Per share data (CNY)

EPS reported (fully diluted)	1.24	1.22	1.25	1.95
HSBC EPS (fully diluted)	1.24	1.22	1.25	1.95
DPS	0.40	0.24	0.25	0.39
Book value	8.23	9.21	10.21	11.77

Key forecast drivers

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Waste incineration GP (RMB m)	127	624	538	688
Residual heat GP (RMB m)	283	244	220	198
Green building materials GP (RMB m)	0	50	300	300
Associate income from Conch (RMB m)	1,980	1,797	1,830	3,324

Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	9.8	5.0	4.7	4.1
EV/EBITDA	27.7	17.7	14.3	13.5
EV/IC	7.2	4.7	4.0	3.3
PE*	13.2	13.4	13.1	8.4
P/Book value	2.0	1.8	1.6	1.4
FCF yield (%)	0.0	-3.6	3.2	4.4
Dividend yield (%)	2.4	1.5	1.5	2.4

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 11 Jun 2015

Valuation and risks

We raise our earnings forecasts by 10% in 2015 and 6% in 2016 as we assume more waste incineration project wins on the back of the favourable outlook for China's environmental protection industry. Our earnings revisions are lower than our revenue revisions as our earnings forecasts on the associate income from cement, the biggest part of the bottom line, are unchanged. We introduce 2017 estimates in this note.

Revised earnings forecasts, RMB m

	Old		New		Change	
	2015E	2016E	2015E	2016E	2015E	2016E
Revenues	2,328	2,885	3,284	3,143	41%	9%
Net income	2,003	2,131	2,204	2,253	10%	6%
EPS, RMB	1.11	1.18	1.22	1.25	10%	6%

Source: HSBC estimates

We downgrade China Conch Venture to Reduce from Hold but raise our TP to HKD15.00 (from HKD14.70) on the back of our earnings changes. Our target price is based on sum-of-the-parts valuation. We apply a 20% discount to Conch Venture's holding in Anhui Conch and Conch Profile, which is broadly in line with the holding company discount in Hong Kong. We calculate that Conch Holdings (which primarily includes Anhui Conch and Conch Profile) should represent about 70% of the company's valuation, waste incineration should represent 19%, and the rest is residual heat and HaiChang Port.

Upside risks: Higher-than-expected waste incineration and residual heat project wins, higher-than-expected earnings contribution from green building materials, and higher-than-expected earnings from companies in Anhui Conch Group.

Sum-of-the-parts valuation

SOTP – RMB m	Stake	Valuation Methodology	Value	Proportional stake
Waste incineration	51%	DCF Valuation [risk free rate of 3.5%, market risk premium of 5.5%, beta of 0.95, WACC of 5.6%]	7,807	3,982
Residual heat power generation	51%	15.1x FY15e PE	2,546	1,298
HaiChang Port	75%	DCF Valuation [risk free rate of 3.5%, market risk premium of 5.5%, beta of 1.00, WACC of 8.4%]	543	407
Conch Holdings	49%	SOTP [We use 1.5x FY15e PB to value Anhui Conch and market value for the holdings in Conch Profiles]	31,668	15,517
Total equity				21,205
# of shares				1,805
Target price, HKD				15.00

Source: Company data, HSBC estimates

Valuation and risks for Anhui Conch (914 HK, HKD28.1, Reduce, TP HKD25, covered by Wei Sim):

We value Anhui Conch at HKD25 on a 1.5x FY15e PB, based on the company's historical trough PB trading multiple. Key upside risks: An unseasonal rebound in ASPs in 1Q 2015 and any new supportive policy measure announcements triggering a rebound in ASPs or boosting near-term sentiment.

Disclosure appendix

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 11 June 2015, the distribution of all ratings published is as follows:

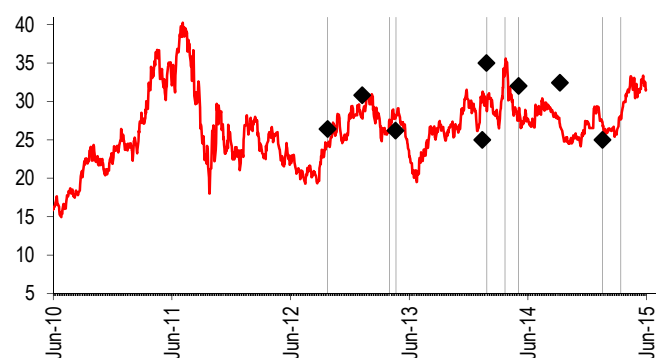
Buy	39%	(29% of these provided with Investment Banking Services)
Hold	43%	(28% of these provided with Investment Banking Services)
Sell	18%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

Anhui Conch H (0914.HK) Share Price performance HKD Vs HSBC rating history

history



Source: HSBC

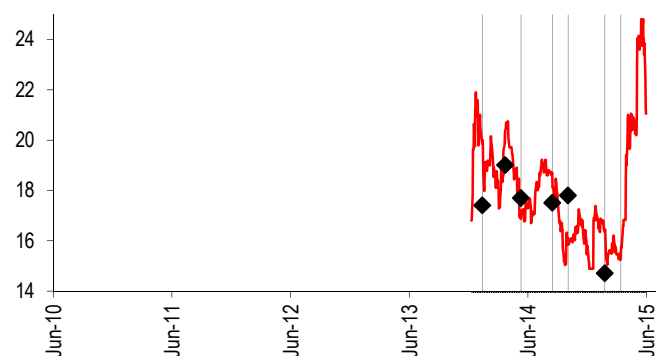
Recommendation & price target history

From	To	Date
Overweight (V)	Neutral (V)	02 October 2012
Neutral (V)	N/A	10 April 2013
N/A	Underweight	30 April 2013
Underweight	Overweight	04 February 2014
Overweight	Neutral	01 April 2014
Neutral	Overweight	13 May 2014
Overweight	Underweight	27 January 2015
Underweight	Reduce	24 March 2015
Target Price	Value	Date
Price 1	26.40	02 October 2012
Price 2	30.80	17 January 2013
Price 3	N/A	10 April 2013
Price 4	26.20	30 April 2013
Price 5	25.00	22 January 2014
Price 6	35.00	04 February 2014
Price 7	32.00	13 May 2014
Price 8	32.40	18 September 2014
Price 9	25.00	27 January 2015

Source: HSBC

China Conch Venture (0586.HK) Share Price performance HKD Vs HSBC rating history

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Underweight (V)	22 January 2014
Underweight (V)	Neutral (V)	20 May 2014
Neutral (V)	Underweight (V)	25 August 2014
Underweight (V)	Neutral (V)	12 October 2014
Neutral (V)	Underweight (V)	03 February 2015
Underweight (V)	Hold	24 March 2015
Target Price	Value	Date
Price 1	17.40	22 January 2014
Price 2	19.00	02 April 2014
Price 3	17.70	20 May 2014
Price 4	17.50	25 August 2014
Price 5	17.80	12 October 2014
Price 6	14.70	03 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
ANHUI CONCH	0914.HK	31.50	10-Jun-2015	4, 5, 6, 7, 11
CHINA CONCH VENTURE	0586.HK	21.05	10-Jun-2015	1

Source: HSBC

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