

# China Resources Cement [1313.HK]

## Time to take a breather; Downgrade to HOLD

We downgrade CR Cement from BUY to HOLD. Although we raise our 2018E/2019E recurring EPS by 3.8%/3.9% after the release of the positive profit alert for 1H2018 and lift the target price from HK\$10.40 (1.95x 2018E PBR) to HK\$11.05 (equivalent to 2.05x 2018E PBR and 9.3x 2018E PER), the potential upside is only 7.1% after a rally of >90% YTD. The valuation is no longer attractive at 1.91x 2018E PBR, which is already higher than the historical average since 2009 by more than one standard deviation. We also see limited upside for cement prices in south China in the near term because of the upcoming rainy season. Investors may consider switching to Conch Cement (0914.HK) and CNBM (3323.HK), which still offer >20% upside based on our target prices.

### Investment Highlights

- 1H2018 positive profit alert released.** CR Cement expects its 1H2018 net profit to increase significantly YoY thanks to higher cement prices. According to the Company, its blended ASP (cement and clinker) rose from HK\$290.5/tonne in 5M2017 to HK\$387.4/tonne in 5M2018.
- Moderate upward revision of profit forecasts.** Our previous blended ASP assumptions for 2018E/2019E were HK\$379/HK\$380. Based on the positive profit alert, we slightly raised our blended ASP assumptions for 2018E/2019E to HK\$384/HK\$385. Therefore, we raise our 2018E/2019E recurring EPS for CR Cement by 3.8%/3.9%. We also raise our target price from HK\$10.40 to HK\$11.05 (2.05x 2018E PBR and 9.3x 2018E PER).
- No longer a bargain after a rally of >90% YTD.** CR Cement is trading at 1.91x 2018E PBR, which is already higher than the historical average since 2009 by more than one standard deviation. In the past, there was a relatively large valuation gap compared with Conch Cement. However, after the recent rally, the valuation gap in terms of PBR between Conch Cement and CR Cement has narrowed to less than 10%, which makes Conch Cement relatively more attractive now.
- Upcoming rainy season to cap cement prices in the near term.** Apart from the valuation, we see limited room to raise the earnings forecast further in the near term due to the rainy season in south China. We may turn more positive again if we see (i) more details about the development plan for the Greater Bay Area, which may drive stronger-than-expected demand for infrastructure investment in south China, and (ii) a higher-than-expected cement price hike in the peak season during late Q3 and Q4.

Y/E Dec 31	2015	2016	2017	2018E	2019E
Turnover (HK\$m)	26,779	25,647	29,958	38,668	38,848
Recurring net profit (HK\$m)	2,055	1,878	3,567	7,801	7,839
Net margin (%)	8	7	12	20	20
Recurring EPS (HK\$)	0.31	0.29	0.55	1.19	1.20
% Change	(52)	(9)	90	119	0
PER (x)	32.8	35.9	18.9	8.6	8.6
PBR (x)	2.54	2.59	2.22	1.91	1.72
EV/EBITDA	18.0	15.3	10.9	6.1	6.1

Sources: Company, CGIS Research

### China Cement Sector

**HOLD** (downgrade from BUY)

Close: HK\$10.32 (June 11, 2018)

Target Price: HK\$11.05 (7.1%)

### Price Performance



Source: Bloomberg

Market Cap	US\$8,592m
Shares Outstanding	6,532.9m
Auditor	Deloitte
Free Float	26.6%
52W range	HK\$3.76-10.38
3M average daily T/O	US\$22.7m
Major Shareholder	China Resources Holdings (73.0%)

Sources: Company, Bloomberg

### Wong Chi Man—Head of Research

(852) 3698-6317

cmwong@chinastock.com.hk

### Mark Lau — Research Analyst

(852) 3698-6393

marklau@chinastock.com.hk

## Key financials

### CR Cement (01313.HK)

#### Income Statement

(HK\$'000, except for per share amount)

Year ended 31 Dec	2015		2016		2017		2015	2016	2017	2018E	2019E
	1H	2H	1H	2H	1H	2H					
Cement	10,300,429	10,406,383	8,824,670	11,348,049	9,901,588	12,959,704	20,706,812	20,172,719	22,861,292	30,548,737	30,919,282
Clinker	607,389	333,671	342,133	597,733	993,422	1,046,368	941,060	939,866	2,039,790	2,220,715	2,338,603
Concrete and others	2,496,390	2,634,409	2,148,805	2,386,074	2,293,374	2,763,972	5,130,799	4,534,879	5,057,346	5,898,578	5,589,980
Revenue	13,404,208	13,374,463	11,315,608	14,331,856	13,188,384	16,770,044	26,778,671	25,647,464	29,958,428	38,668,031	38,847,865
COGS	(10,050,659)	(10,310,745)	(8,618,553)	(10,003,452)	(9,292,790)	(11,435,143)	(20,361,404)	(18,622,005)	(20,727,933)	(23,600,922)	(23,615,550)
Gross profit	3,353,549	3,063,718	2,697,055	4,328,404	3,895,594	5,334,901	6,417,267	7,025,459	9,230,495	15,067,108	15,232,314
Operating expenses	(1,741,438)	(2,313,147)	(1,647,255)	(2,191,873)	(1,604,381)	(2,623,368)	(4,054,585)	(3,839,128)	(4,227,749)	(4,821,689)	(5,027,188)
Operating profit	1,612,111	750,571	1,049,800	2,136,531	2,291,213	2,711,533	2,362,682	3,186,331	5,002,746	10,245,419	10,205,126
Other gains and losses	139,665	270,696	111,993	111,721	107,879	194,445	410,361	223,714	302,324	489,580	403,347
EBIT	1,751,776	1,021,267	1,161,793	2,248,252	2,399,092	2,905,978	2,773,043	3,410,045	5,305,070	10,735,500	10,608,474
Net finance costs	(246,603)	(257,317)	(336,784)	(313,337)	(275,496)	(294,250)	(503,920)	(650,121)	(569,746)	(511,677)	(410,274)
Profits from associates/JCEs	(126,551)	(117,650)	(153,061)	103,510	29,074	69,886	(244,201)	(49,551)	98,960	221,193	227,430
Non-recurrent items	8,920	(1,049,443)	(163,141)	(388,818)	33,548	16,206	(1,040,523)	(551,959)	49,754	95,128	-
Income before tax	1,387,542	(403,143)	508,807	1,649,607	2,186,218	2,697,820	984,399	2,158,414	4,884,038	10,539,644	10,425,629
Income tax expense	102,311	(149,821)	(286,728)	(610,116)	(573,454)	(717,967)	(47,510)	(896,844)	(1,291,421)	(2,709,180)	(2,651,532)
Minority interests	40,370	37,710	35,448	28,837	27,038	(2,913)	78,080	64,285	24,125	65,768	65,386
Net income	1,530,223	(515,254)	257,527	1,068,328	1,639,802	1,976,940	1,014,969	1,325,855	3,616,742	7,896,232	7,839,483
Recurring net income	1,521,303	534,189	420,668	1,457,146	1,606,254	1,960,734	2,055,492	1,877,814	3,566,988	7,801,104	7,839,483
EPS (HK\$)	0.234	(0.079)	0.039	0.164	0.251	0.303	0.155	0.203	0.554	1.209	1.200
Recurring EPS (HK\$)	0.233	0.082	0.064	0.223	0.246	0.300	0.315	0.287	0.546	1.194	1.200
DPS (HK\$)	0.060	0.020	0.015	0.075	0.115	0.155	0.080	0.090	0.270	0.604	0.600
Depreciation and amortization	945,611	940,078	899,226	923,649	898,089	952,795	1,885,689	1,822,875	1,850,884	2,016,199	2,112,659
EBITDA	2,570,836	1,843,695	1,907,958	3,275,411	3,326,255	3,928,659	4,414,531	5,183,369	7,254,914	12,972,391	12,948,563
Blended cement and clinker ASP (HK\$)	291	245	235	261	290	303	266	249	297	384	385
Cement and clinker vol. ('000 tonnes)	37,470	43,883	39,070	45,826	37,611	46,232	81,353	84,896	83,843	85,275	86,320
Cement and clinker gross profit (HK\$/tonne)	71	52	52	79	88	100	61	67	95	161	162
Concrete ASP (HK\$/tonne)	435	401	374	359	371	380	417	366	376	402	408
Concrete vol. ('000 m3)	5,734	6,577	5,740	6,655	6,175	7,283	12,311	12,395	13,458	14,690	13,686
Concrete gross profit (HK\$/m3)	120	120	114	102	97	97	120	108	97	92	93
<b>Growth Rates:</b>											
Revenue	-12%	-24%	-16%	7%	17%	17%	-18%	-4%	17%	29%	0%
EBIT	-46%	-66%	-34%	120%	106%	29%	-56%	23%	56%	102%	-1%
EBITDA	-38%	-55%	-26%	78%	74%	20%	-47%	17%	40%	79%	0%
Core net income	-31%	-75%	-72%	173%	282%	35%	-52%	-9%	90%	119%	0%
Recurring EPS	-31%	-75%	-72%	173%	282%	35%	-52%	-9%	90%	119%	0%
<b>Margins and Ratios:</b>											
Gross margin	25.0%	22.9%	23.8%	30.2%	29.5%	31.8%	24.0%	27.4%	30.8%	39.0%	39.2%
Net margin	11.0%	3.7%	3.4%	10.0%	12.0%	11.7%	7.4%	7.1%	11.8%	20.0%	20.0%
EBIT margin	13.1%	7.6%	10.3%	15.7%	18.2%	17.3%	10.4%	13.3%	17.7%	27.8%	27.3%
EBITDA margin	19.2%	13.8%	16.9%	22.9%	25.2%	23.4%	16.5%	20.2%	24.2%	33.5%	33.3%
Effective tax rate	-7.4%	23.2%	42.7%	29.9%	26.6%	26.8%	2.3%	33.1%	26.7%	25.9%	25.4%

Sources: Company data, CGIS Research estimates

## Key financials

### CR Cement (01313.HK)

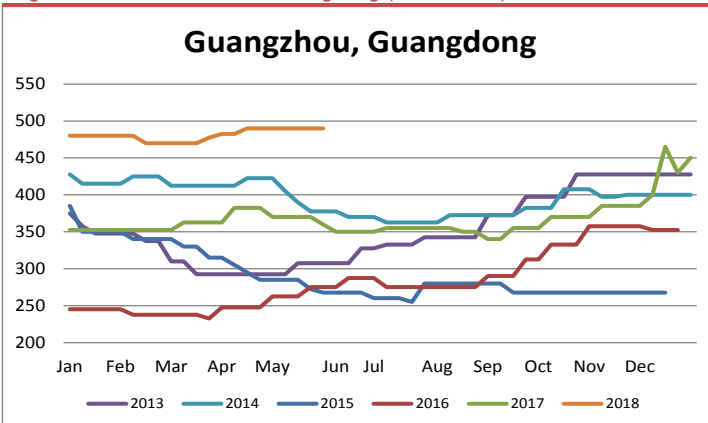
#### Balance Sheet

(HK\$'000, except for per share amount)

As at 31 Dec	2015	2016	2017	2018E	2019E
Inventories	1,564,912	1,943,482	1,717,455	2,000,000	2,050,000
Trade and other receivables	2,194,070	2,434,190	2,593,819	2,800,000	2,850,000
Others	1,674,932	1,537,515	2,199,681	2,244,929	2,244,929
Bank balances and cash	1,937,708	3,158,684	5,384,094	9,100,145	13,074,919
Total current assets	7,371,622	9,073,871	11,895,049	16,145,074	20,219,848
PPE, net	31,596,192	29,783,669	30,902,575	29,997,376	28,658,717
Prepaid lease payments	2,905,451	2,674,723	2,816,137	2,816,137	2,816,137
Others	12,343,485	10,624,248	10,912,841	11,134,034	11,361,464
Total non-current assets	46,845,128	43,082,640	44,631,553	43,947,547	42,836,318
Total assets	54,216,750	52,156,511	56,526,602	60,092,622	63,056,166
Trade payables	3,089,768	3,145,780	3,374,633	3,500,000	3,550,000
Other payables	4,855,226	4,446,121	4,966,250	5,200,000	5,250,000
Bank and other borrowings	5,226,642	6,890,720	6,572,157	5,000,000	5,000,000
Others	230,468	334,213	443,893	1,354,590	1,325,766
Total current liabilities	13,402,104	14,816,834	15,356,933	15,054,590	15,125,766
Bank and other borrowings	10,597,782	7,615,712	6,990,479	6,000,000	5,000,000
Others	3,231,187	3,472,096	3,696,749	3,696,749	3,696,749
Total non-current liabilities	13,828,969	11,087,808	10,687,228	9,696,749	8,696,749
Total liabilities	27,231,073	25,904,642	26,044,161	24,751,339	23,822,515
Shareholders' equity	26,556,891	26,006,768	30,308,969	35,233,579	39,191,333
Minority interests	428,786	245,101	173,472	107,704	42,318

Sources: Company data, CGIS Research estimates

Figure 1: Cement Prices in Guangdong (RMB/tonne)



Sources: Digital Cement, CGIS Research

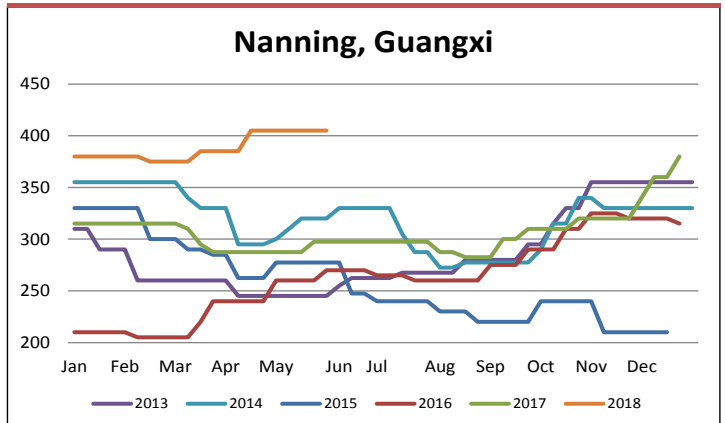
### Statement of Cash Flow

Year ended 31 Dec	2015	2016	2017	2018E	2019E
Profit before tax	984,399	2,158,414	4,884,038	10,539,644	10,425,629
Depreciation & Amortization	1,860,264	1,766,685	1,867,990	2,016,199	2,112,659
Others / adjustments	89,102	922,286	(1,067,008)	(993,182)	(2,819,774)
Net operating cash flow	4,833,639	4,111,744	6,612,947	11,387,803	9,718,515
Capex	(2,352,030)	(2,120,472)	(1,134,926)	(1,161,000)	(824,000)
Others	(2,289,851)	449,129	(753,319)	-	-
Net investing cash flow	(4,641,881)	(1,671,343)	(1,888,245)	(1,161,000)	(824,000)
Change in debt	(1,356,788)	(1,317,992)	(943,796)	(2,562,636)	(1,000,000)
Dividends	(1,110,599)	(522,635)	(1,763,905)	(3,948,116)	(3,919,742)
Others	222,277	806,023	(83,766)	-	-
Net financing cash flow	(2,245,110)	(1,034,604)	(2,791,467)	(6,510,752)	(4,919,742)
Increase / Decrease in cash	(2,210,096)	1,220,976	2,225,410	3,716,051	3,974,773
Net cash/(debt)	(16,987,100)	(14,701,538)	(11,767,442)	(5,488,755)	(513,981)

### Finance Ratios

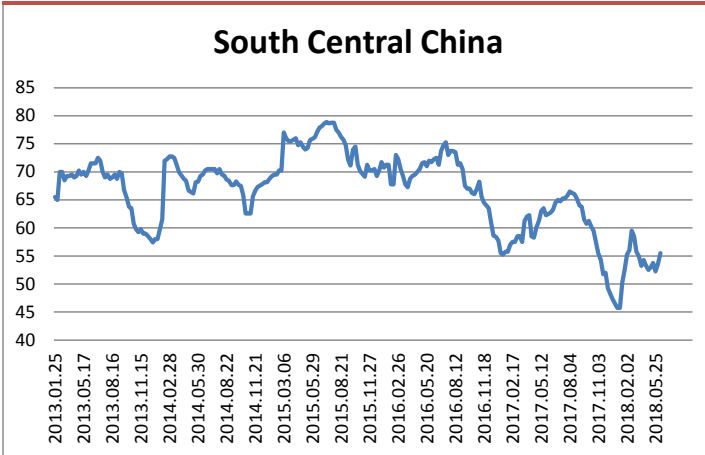
	2015	2016	2017	2018E	2019E
<b>Valuation</b>					
PE(x)	32.8	35.9	18.9	8.6	8.6
EPS growth (%)	(52.2)	(8.6)	90.0	118.7	0.5
Yield (%)	0.8	0.9	2.6	5.9	5.8
PEG (x)	-0.63	-4.15	0.21	0.07	17.48
EV/EBITDA (x)	18.0	15.3	10.9	6.1	6.1
FB(x)	2.54	2.59	2.22	1.91	1.72
<b>Operational</b>					
Revenue growth (%)	-	18	4	17	29
Gross margin (%)	24.0	27.4	30.8	39.0	39.2
Net profit margin (%)	7.4	7.1	11.8	20.0	20.0
Days receivables	34	33	31	25	27
Days payables	53	61	57	53	54
Days inventories	33	34	32	29	31
Current ratio (x)	0.6	0.6	0.8	1.1	1.3
Quick ratio (x)	0.3	0.4	0.5	0.8	1.1
Asset/Equity (x)	2.0	2.0	1.9	1.7	1.6
Net debt/equity (%)	63	56	39	16	1
EBITDA interest coverage (x)	8.8	8.0	12.7	25.4	31.6
Core ROE (%)	7.5	7.1	12.7	27.7	23.9

Figure 2: Cement Prices in Guangxi (RMB/tonne)



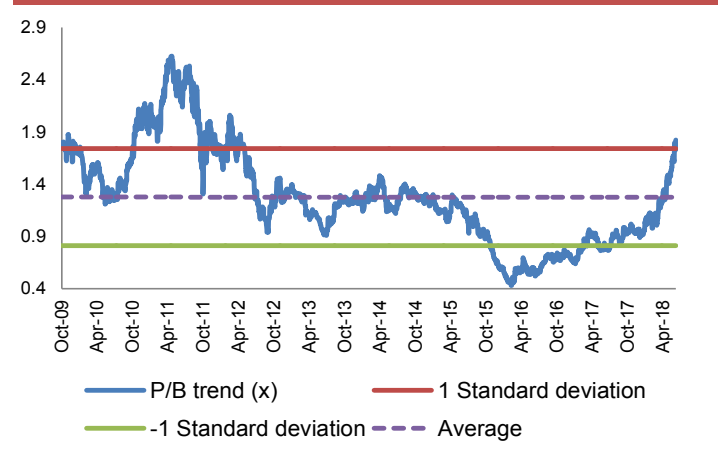
Sources: Digital Cement, CGIS Research

Figure 3: Cement inventory level in south central China



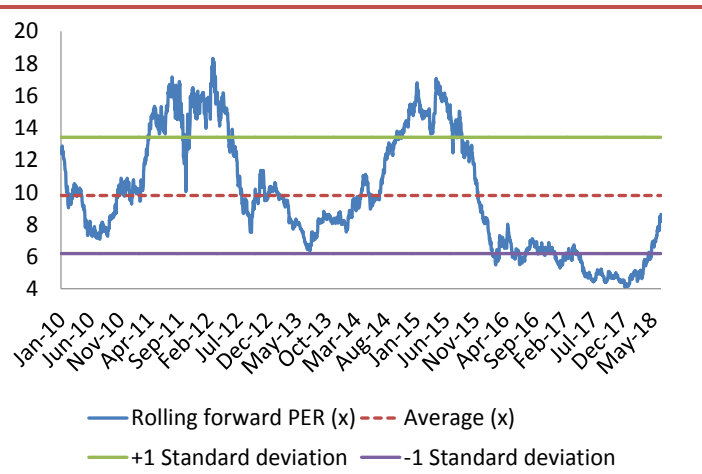
Sources: Digital Cement, CGIS Research

Figure 4: CR Cement Rolling Forward PBR Range



Sources: Bloomberg, CGIS Research

Figure 5: CR Cement Rolling Forward PER Range



Sources: Bloomberg, CGIS Research

**Disclaimer**

This research report is not directed at, or intended for distribution to or used by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject China Galaxy International Securities (Hong Kong) Co., Limited ("Galaxy International Securities") and/or its group companies to any registration or licensing requirement within such jurisdiction.

This report (including any information attached) is issued by Galaxy International Securities, one of the subsidiaries of the China Galaxy International Financial Holdings Limited, to the institutional clients from the information sources believed to be reliable, but no representation or warranty (expressly or implied) is made as to their accuracy, correctness and/or completeness.

This report shall not be construed as an offer, invitation or solicitation to buy or sell any securities of the company(ies) referred to herein. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. The recipient of this report should understand and comprehend the investment objectives and its related risks, and where necessary consult their own independent financial advisers prior to any investment decision.

Where any part of the information, opinions or estimates contained herein reflects the personal views and opinions of the analyst who prepared this report, such views and opinions may not correspond to the published views or investment decisions of China Galaxy International Financial Holdings Limited and any of its subsidiaries ("China Galaxy International"), directors, officers, agents and employees ("the Relevant Parties").

All opinions and estimates reflect the judgment of the analyst on the date of this report and are subject to change without notice. China Galaxy International and/or the Relevant Parties hereby disclaim any of their liabilities arising from the inaccuracy, incorrectness and incompleteness of this report and its attachment/s and/or any action or omission made in reliance thereof. Accordingly, this report must be read in conjunction with this disclaimer.

**Disclosure of Interests**

China Galaxy Securities Co., Ltd. (6881.HK; 601881.CH) is the direct and/or indirect holding company of the group of companies under China Galaxy International.

China Galaxy International may have financial interests in relation to the subjected company(ies) the securities in respect of which are reviewed in this report, and such interests aggregate to an amount may equal to or more than 1 % of the subjected company(ies)' market capitalization.

One or more directors, officers and/or employees of China Galaxy International may be a director or officer of the securities of the company(ies) mentioned in this report.

China Galaxy International and the Relevant Parties may, to the extent permitted by law, from time to time participate or invest in financing transactions with the securities of the company(ies) mentioned in this report, perform services for or solicit business from such company(ies), and/or have a position or holding, or other material interest, or effect transactions, in such securities or options thereon, or other investments related thereto.

China Galaxy International may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the last 12 months, significant advice or investment services in relation to the investment concerned or a related investment or investment banking services to the company(ies) mentioned in this report.

Furthermore, China Galaxy International may have received compensation for investment banking services from the company(ies) mentioned in this report within the preceding 12 months and may currently seeking investment banking mandate from the subject company(ies).

**Analyst Certification**

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

**Explanation on Equity Ratings**

- BUY : share price will increase by >20% within 12 months in absolute terms
- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

**Copyright Reserved**

No part of this material may be reproduced or redistributed without the prior written consent of China Galaxy International Securities (Hong Kong) Co., Limited.

China Galaxy International Securities (Hong Kong) Co. Limited, CE No.AXM459

Room 3501-3507, 35/F, Cosco Tower, Grand Millennium Plaza, 183 Queen's Road Central, Sheung Wan, Hong Kong. General line: 3698-6888.