

China / Hong Kong Company Guide

Anhui Conch Cement

Version 8 | Bloomberg: 914 HK Equity | 600585 CH Equity | Reuters: 0914.HK | 600585.SS

Refer to important disclosures at the end of this report

DBS Group Research . Equity

11 Jan 2018

H: BUY

Last Traded Price (H) (11 Jan 2018):HK\$40.45 (HSI : 31,120)

Price Target 12-mth (H): HK\$52.74 (30% upside) (Prev HK\$40.00)

A: BUY

Last Traded Price (A) (11 Jan 2018):RMB31.24 (CSI300 Index : 4,208)

Price Target 12-mth (A): RMB40.35 (29% upside) (Prev RMB31.23)

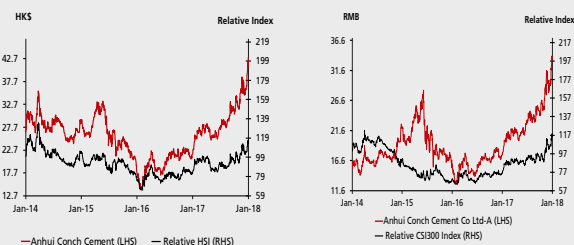
Analyst

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What's New

- Share price pullback during the low season in 1Q could be mild, cushioned by bright earnings prospects and dividend yield
- Raised earnings on higher cement price with FY18 core earnings expected to rise 40%
- Our FY17/18F earnings are 7%/24% above consensus
- Remains top pick in cement sector

Price Relative



Forecasts and Valuation (H Shares)

FY Dec (RMB m)	2016A	2017F	2018F	2019F
Turnover	55,932	73,213	84,067	90,007
EBITDA	17,244	26,550	32,240	35,195
Pre-tax Profit	11,699	20,853	26,447	29,435
Net Profit	8,574	15,228	19,314	21,496
Net Profit Gth (Pre-ex) (%)	13.7	77.6	26.8	11.3
EPS (RMB)	1.62	2.87	3.64	4.06
EPS (HK\$)	1.94	3.45	4.38	4.88
Core EPS (HK\$)	1.67	3.14	4.38	4.88
Core EPS (RMB)	1.39	2.61	3.64	4.06
EPS Gth (%)	13.7	77.6	26.8	11.3
Core EPS Gth (%)	28.5	75.2	39.5	11.3
Diluted EPS (HK\$)	1.94	3.45	4.38	4.88
DPS (HK\$)	0.60	1.55	1.97	2.19
BV Per Share (HK\$)	17.31	20.25	23.97	28.12
PE (X)	20.8	11.7	9.2	8.3
Core PE (X)	24.2	12.9	9.2	8.3
P/Cash Flow (X)	14.6	10.0	7.6	6.6
P/Free CF (X)	23.9	20.8	10.7	8.9
EV/EBITDA (X)	11.1	7.0	5.5	4.7
Net Div Yield (%)	1.5	3.8	4.9	5.4
P/Book Value (X)	2.3	2.0	1.7	1.4
Net Debt/Equity (X)	0.1	0.0	CASH	CASH
ROAE (%)	11.7	18.4	19.8	18.7
Earnings Rev (%):		10	29	28
Consensus EPS (RMB)		2.679	2.934	3.012
Other Broker Recs:		B: 13	S: 2	H: 5

Source of all data on this page: Company, DBSV, Thomson Reuters, HKEX

Upward path on earnings prospects

Reiterate BUY, raised FY17/18F earnings by 10%/29%. Since our last report dated 24 October 2017, cement selling prices in China have been upbeat, led by price rally in East and Central China (accounting for 58% of Conch's sales volume), mainly due to low inventory from supply discipline. Kiln closures in Shandong and Henan for winter heating season (15 November 2017 to 15 March 2018) have been well executed. In 4Q17, average cement selling prices in East and Central China had hiked 29% q-o-q (or Rmb78/t) and 25% q-o-q (or Rmb66/t) respectively. Based on strong cement gross profit margin at end-December, we expect 1Q18 cement profitability to be upbeat. We have upgraded FY18F unit GP to Rmb110/t vs Rmb88/t forecast previously.

Cement inventory levels are at historical low. Current cement inventories (as a % of storage capacity) in East, Central & South China are 44%, 46% and 44% respectively, which are 17-20ppt lower than the historical average, and the lowest levels compared to the same period in the past five years (2013-17). This could help prevent cement selling prices from dropping significantly in the upcoming 1Q18 low season.

Industry supply/demand dynamics could improve further in 2018; lift cement consumption forecasts in 2018. Over the first 11 months of 2017, cement consumption in East, Central and South China grew 2.1% y-o-y vs the country's consumption decline of 0.2% y-o-y. In 2018, we now forecast China's cement consumption to increase 1.8% y-o-y to 2,448mt, fuelled by expected recovery in property construction as property industry's destocking extends and policy stabilises. Based on a statement from the annual Central Economic Work Conference on 20 December 2017, China is to keep the continuity and stability of the real estate market's regulatory policies, to ensure supply through multiple sources. We forecast demand of property, infrastructure and urbanisation construction to rise 2.0%/2.9%/0.5%, demand growth in East, Central and South China to outstrip the country's average. On the supply side, we only project 15mt new capacity to come on stream, translating to an increase rate of 0.5%.

Valuation:

We raised our H-share TP to HK\$52.74, led by earnings upgrade. Our H-share target valuation is pegged at an unchanged 12.0x FY18F PE. The positives include possibly upbeat 1Q18 cement profitability, continuous low cement & clinker inventory, FY17F dividend payout hike and business development of aggregates. Our A-share TP is hiked to Rmb40.35.

Key Risks to Our View:

Cement selling prices fail to hike in 2Q18 strong seasonal recovery.

At A Glance

Issued Capital - H shares (m shs)	1,300
- Non H shares (m shs)	4,000
H shs as a % of Total	25
Total Mkt. Cap (HK\$m/US\$m)	214,357 / 27,403
Major Shareholders	
Anhui Conch Holdings (%)	36.8
Major H Shareholders	
J.P.Morgan Chase & Co. (%)	8.8
BlackRock, Inc. (%)	6.0
Standard Life Aberdeen plc	5.9
Schroders Plc (%)	5.1
H Shares-Free Float (%)	74.1
3m Avg. Daily Val. (US\$m)	47.4
ICB Industry : Industrials / Construction & Materials	



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WHAT'S NEW

China cement sector's share prices undergo correction on decline in clinker prices in East China

Share prices of Anhui Conch, CNBM and CR Cement pulled back by 5-7%. News comes that clinker prices alongside East China Yangtze River Delta region have been cut by around Rmb120-130/t, effective from today (11 January 2018). Following the price cut, clinker prices are Rmb350-380/t. While the market reads the significant price cut as a negative surprise, we are not too concerned about that after our discussion with the cement association and industry players.

Firstly, it is not price competition given current low inventory across East China cement companies (inventory as % percentage of storage capacity is around 45% which is undemanding). Thus, the significant price cut is a strategy move to prevent Vietnam's imported clinker from taking market in low season in 1Q18. We understand prevalent clinker prices of Vietnam imports are around Rmb380/t, and its shipment started to pick up in Nov-and-Dec 2017 when East China's price started to spike above Rmb390/t in mid-Nov 2017 to Rmb500/t at year end.

According to our channel checks, Vietnam's clinker imports might have increased to around 0.3-0.4mt in Dec 2017

following 0.18mt in Nov 2017, versus 0.07mt per month on average in 3Q17. In context of clinker consumption of around 430mt in East China per annum, we think the Vietnam imports are hardly an overhang for the industry.

Given current low clinker inventory across East China players, together with upcoming expected kiln closure during CNY (Chinese New Year) holidays, we think inventory level will largely remain comfortable for the region.

Secondly, we think such price adjustment for clinker is one-terminal and expect cement selling prices to decline gradually in line with weak seasonal behavior. Given large cement companies like Conch has negligible external clinker sales, the price adjustment has limited impact on its earnings outlook.

Near term share prices could be under pressure after YTD share price rally. We expect strong 1Q18 cement profitability as the cement prices are to pull back from record high profitability in early 2018. Suggest to accumulate on share price weakness. Anhui Conch remains top pick.

CRITICAL FACTORS TO WATCH

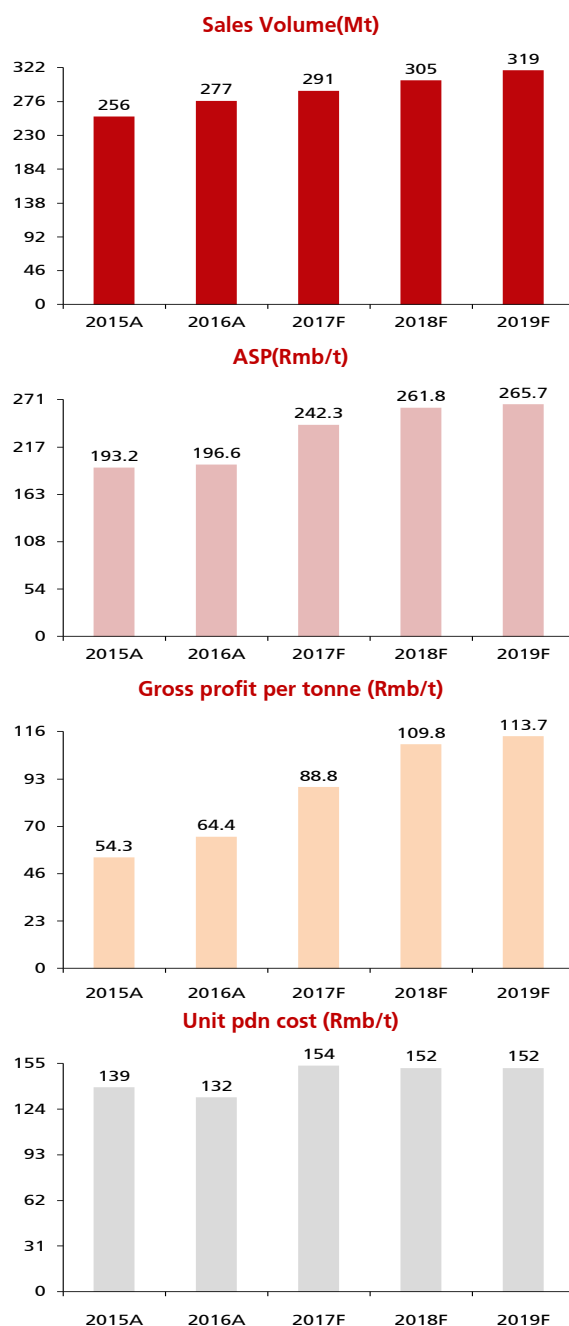
Critical Factors

Industry supply/demand dynamics in 2018. In 2018, we project Chinese cement demand to increase 1.8% y-o-y to 2,448mt, following an estimated decline of 0.1% for cement consumption in 2017. This is to reflect growth forecasts for infrastructure (+2.9%), urbanisation construction (+0.5%), and the property segment (+2.0%). We estimate that infrastructure segment, urbanisation construction and property segment account for 34%, 35% and 31% of China's cement consumption respectively. On the supply side, we only project 15mt new capacity to come on stream, translating to an increase rate of 0.5%. As such, cement industry supply-and-demand dynamics are set to improve further in 2018.

Cement prices. Anhui Conch, being one of the largest cement producers in China, has 29%/29%/16% of the company's cement & clinker sales volume exposed to East, Central and South China respectively. In 2018, we are projecting Conch's blended cement & clinker ASP to increase 8.1% y-o-y. We estimate that every 1% change in blended cement & clinker ASP will swing FY17F earnings by 2.5%.

Production cost. Fuel & power and raw materials (mainly limestone, gypsum, etc.) account for around 59%/17% of Conch's production cost respectively. We believe thermal coal prices peaked in December 2016 as China temporarily relaxed its '276-day annual operating limit' policy for the coal industry from November 2016 to March 2017. In 2017, thermal coal prices peaked in April at Rmb605/t (incl. VAT), with Qinghuangdao (QHD) coal prices started the year at Rmb595/t (incl. VAT) and ended the year at Rmb580/t (incl. VAT). In 2018, we forecast QHD coal prices to decline 2.6% y-o-y to Rmb571/t (incl. VAT). Our FY18F unit production cost of Conch is Rmb152/t versus an estimated Rmb153.5/t for FY17. We estimate that every 1% change in thermal coal prices will swing FY17F earnings by 1.0%.

Aggregates business. The company's aggregates business has scaled up since 1H17. Aggregates is a by-product of limestone stripping and has a high content of magnesium, which is the feedstock of concrete products. Owing to the Chinese government's stricter environmental inspection on limestone quarries since 2H16, small-sized quarries have been effectively shut down. We foresee tightened environmental policy to remain intact, which is supportive for high GP margin of aggregates to sustain. Conch targets to expand output capacity of aggregates to 100mt as of end-2020 vs 25mt as of end-2016.

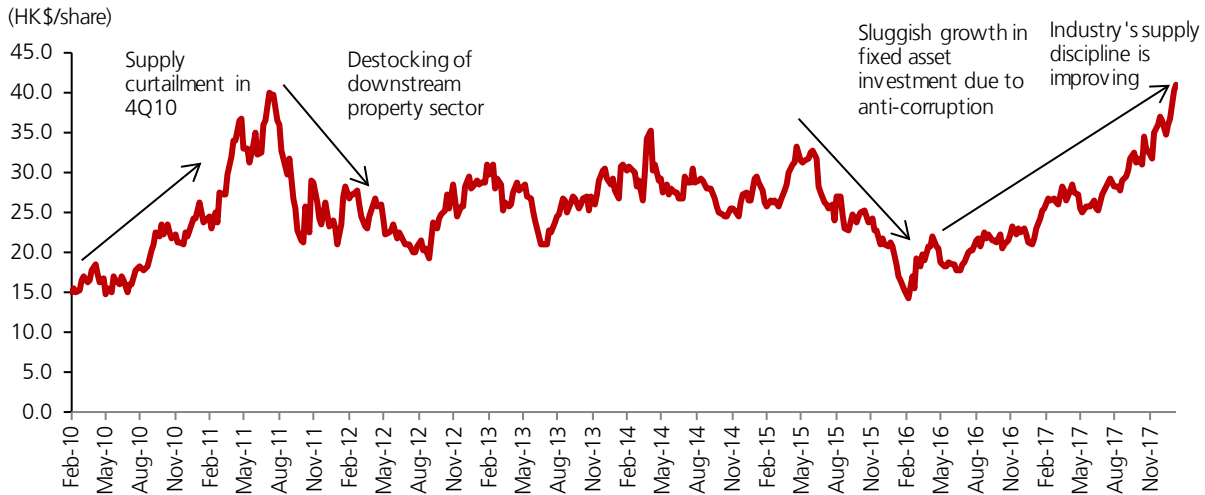


Source: Company, DBS Vickers

Anhui Conch Cement

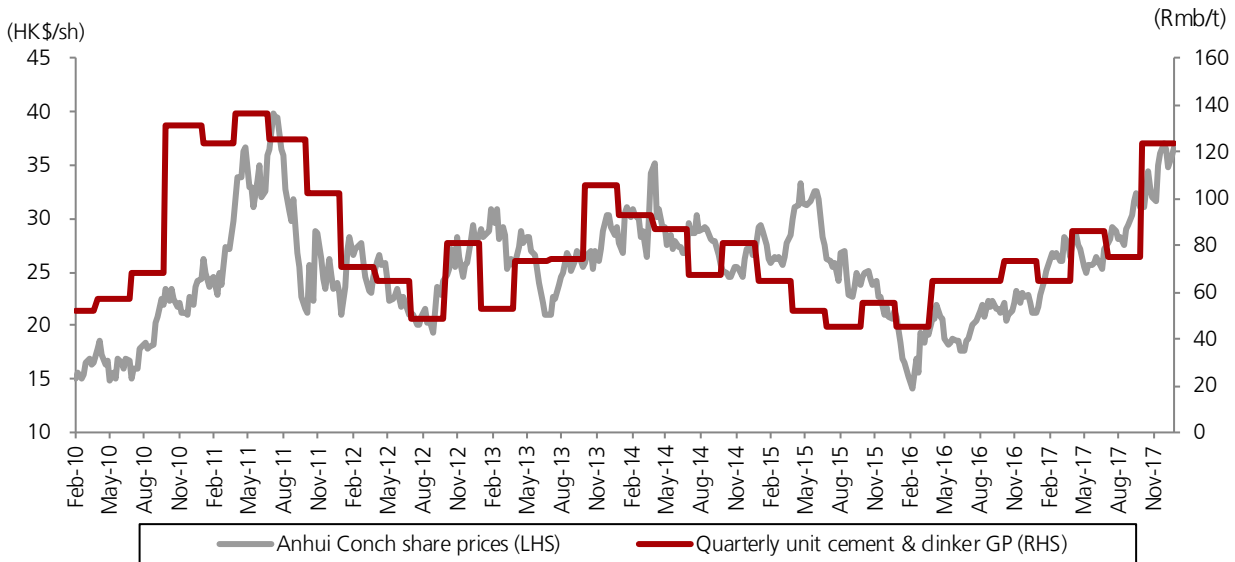
Appendix 1: A look at Company's listed history – what drives its share price?

Anhui Conch: Share price performance



Source: Bloomberg Finance L.P., DBS Vickers

Anhui Conch: Share price vs Unit cement & clinker gross profit*



Source: Bloomberg Finance L.P., DBS Vickers

Note: We forecast 4Q17E unit cement & clinker gross profit was Rmb124/t

Balance Sheet:

Balance sheet to position stronger with FCF yield of 10.8% for FY18F. Anhui Conch has the strongest balance sheet in the Chinese basic material sector universe. Our FY17/18F Op-CF are Rmb17.8bn and Rmb23.6bn respectively, driven by stronger cement business margin. This compares to respective capex of Rmb9.0bn and Rmb6.7bn. Due to stronger cash flow position, we expect the company to raise its FY17 dividend payout to 45% versus 31% in FY16, in order to retain a high ROE.

Share Price Drivers:

Cement demand. I) Infrastructure – “Three-year action plan”: in November 2016, the NDRC (National Development and Reform Commission) and the Ministry of Transport jointly published the official “Three-year action plan for the construction of mega infrastructure facilities” in 2016-18 with investments amounting to Rmb4.7tr. We estimate this to boost total cement consumption by 470-564mt. This has yet to factor in the contribution of ‘one-belt one-road’ projects. II) Property GFA (gross floor area) of new starts. Chinese residential inventory (covering 11 major tier I & tier II cities) remained low at 6.2-month in November 2017 versus 5.8-month in December 2016 versus 10.2-month in December 2015, against levels of 8.5-11.5 months during the previous property construction down-cycle in July 2011 and April 2014.

China to abolish 32.5 grade cement products. If China abolishes all 32.5 grade cement products, cement producers will switch to producing P.C 42.5 cement products instead. This will lead to an increase of 8.5-17% in clinker consumption, given that clinker makes up 60-70% of raw materials required to produce one ton of 42.5 grade cement products, compared to 50% for 32.5 grade products.

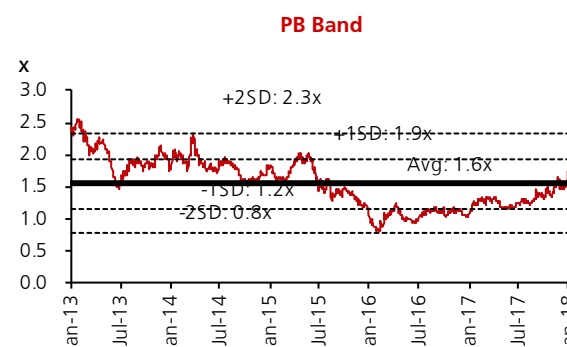
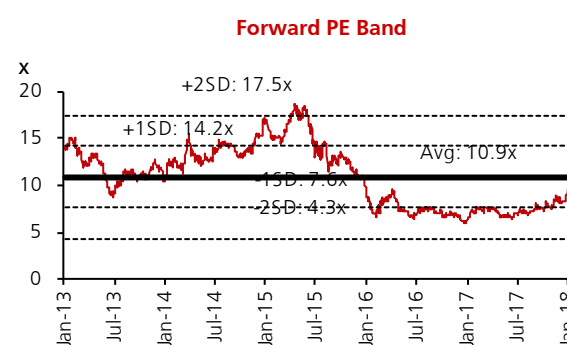
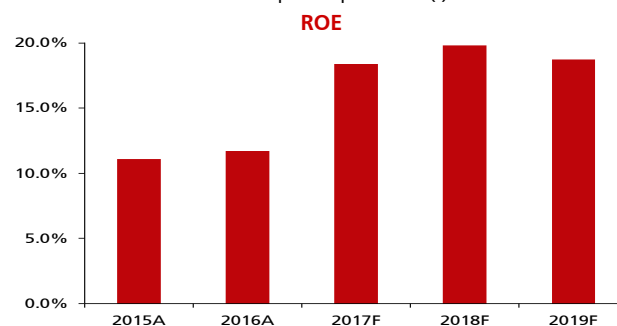
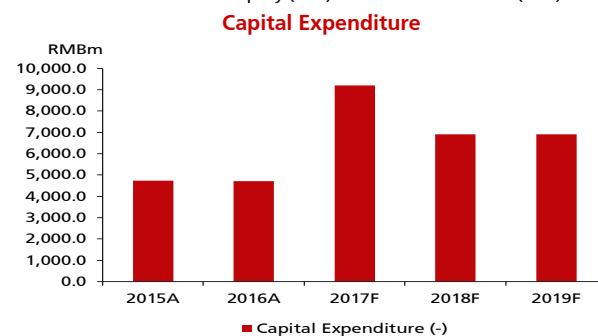
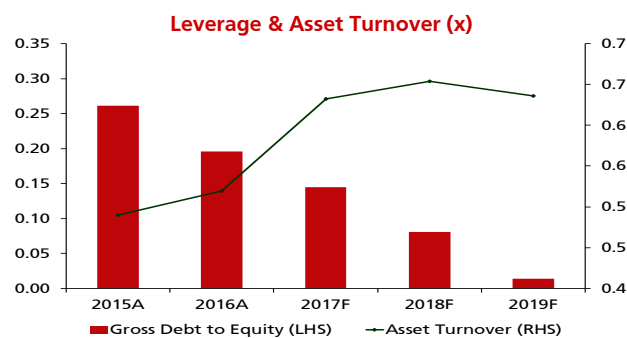
Key Risks:

Demand risk. Worse-than-expected infrastructure construction activities would influence cement consumption in 2018.

Capacity resumption risk. Curtailment in capacity of Shandong and Henan for winter heating season takes place during 15 November 2017 to 15 March 2018. The operation resumption of the capacity after 15 March 2018 will post supply risk contemporarily.

Company Background

Anhui province government-owned enterprise, Anhui Conch (Conch) is China’s second largest cement producer with output capacity of 244mt of clinker and 313mt of cement as of end-FY16. It has sales exposure to East China (29%), Central China (29%), South China (16%) and West China (23%). Conch is China’s largest cement exporter and exported around 11.6mt cement and clinker in 2016. The company had 25mt output capacity of aggregates as of end-2016. It is expanding its cement capacity in Indonesia and Cambodia.



Source: Company, DBS Vickers

Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
Sales Volume(Mt)	256.0	277.0	290.9	305.4	319.1
ASP(Rmb/t)	193.2	196.6	242.3	261.8	265.7
Gross profit per tonne (Rmb/t)	54.3	64.4	88.8	109.8	113.7
Unit pdn cost (Rmb/t)	138.9	132.2	153.5	152.0	152.0

Source: Company, DBS Vickers

Income Statement (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	50,976	55,932	73,213	84,067	90,007
Cost of Goods Sold	(37,267)	(38,396)	(46,831)	(49,266)	(51,919)
Gross Profit	13,709	17,536	26,382	34,800	38,089
Other Opng (Exp)/Inc	(6,290)	(6,806)	(8,141)	(9,448)	(10,109)
Operating Profit	7,419	10,730	18,241	25,352	27,980
Other Non Opg (Exp)/Inc	3,667	1,859	3,292	1,620	1,710
Associates & JV Inc	(38)	(97)	0	0	0
Net Interest (Exp)/Inc	(963)	(792)	(680)	(525)	(255)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	10,086	11,699	20,853	26,447	29,435
Tax	(2,440)	(2,703)	(4,852)	(6,154)	(6,849)
Minority Interest	(106)	(423)	(773)	(980)	(1,090)
Preference Dividend	0	0	0	0	0
Net Profit	7,539	8,574	15,228	19,314	21,496
Net Profit before Except.	7,539	8,574	15,228	19,314	21,496
EBITDA	15,508	17,244	26,550	32,240	35,195
Growth					
Revenue Gth (%)	(16.1)	9.7	30.9	14.8	7.1
EBITDA Gth (%)	(21.7)	11.2	54.0	21.4	9.2
Opg Profit Gth (%)	(49.1)	44.6	70.0	39.0	10.4
Net Profit Gth (%)	(31.3)	13.7	77.6	26.8	11.3
Margins & Ratio					
Gross Margins (%)	26.9	31.4	36.0	41.4	42.3
Opg Profit Margin (%)	14.6	19.2	24.9	30.2	31.1
Net Profit Margin (%)	14.8	15.3	20.8	23.0	23.9
ROAE (%)	11.1	11.7	18.4	19.8	18.7
ROA (%)	7.2	8.0	13.2	15.0	15.2
ROCE (%)	6.1	8.6	13.6	17.0	16.9
Div Payout Ratio (%)	30.2	30.9	45.0	45.0	45.0
Net Interest Cover (x)	7.7	13.5	26.8	48.3	109.7

Source: Company, DBS Vickers

Interim Income Statement (RMB m)

FY Dec	1H2015	2H2015	1H2016	2H2016	1H2017
Revenue	24,223	26,753	23,973	31,959	31,908
Cost of Goods Sold	(17,635)	(19,632)	(16,790)	(21,606)	(22,018)
Gross Profit	6,588	7,121	7,183	10,353	9,890
Other Oper. (Exp)/Inc	(2,687)	(3,602)	(2,949)	(3,857)	(2,958)
Operating Profit	3,901	3,519	4,234	6,496	6,932
Other Non Opg (Exp)/Inc	2,830	837	814	1,044	2,644
Associates & JV Inc	33	(72)	(68)	(29)	(1)
Net Interest (Exp)/Inc	(500)	(463)	(454)	(338)	(348)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	6,265	3,821	4,527	7,173	9,228
Tax	(1,514)	(926)	(1,064)	(1,639)	(2,147)
Minority Interest	(36)	(71)	(104)	(319)	(342)
Net Profit	4,714	2,824	3,359	5,215	6,739
Net profit bef Except.	4,714	2,824	3,359	5,215	6,739

Growth

Revenue Gth (%)	(15.8)	(16.3)	(1.0)	19.5	33.1
Opg Profit Gth (%)	(49.9)	(48.2)	8.5	84.6	63.7
Net Profit Gth (%)	(18.9)	(45.6)	(28.8)	84.7	100.6

Margins

Gross Margins (%)	27.2	26.6	30.0	32.4	31.0
Opg Profit Margins (%)	16.1	13.2	17.7	20.3	21.7
Net Profit Margins (%)	19.5	10.6	14.0	16.3	21.1

Source: Company, DBS Vickers

Balance Sheet (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	64,108	64,661	68,769	70,626	72,256
Invts in Associates & JVs	2,975	3,315	3,500	3,650	3,800
Other LT Assets	12,272	11,954	9,002	12,175	17,309
Cash & ST Invts	4,471	6,065	10,470	16,389	21,266
Inventory	4,238	4,549	5,386	5,666	5,971
Debtors	7,056	9,049	10,982	12,610	13,501
Other Current Assets	10,660	9,920	13,910	13,930	13,950
Total Assets	105,781	109,514	122,018	135,046	148,053
ST Debt	8,445	4,538	4,538	4,538	1,000
Creditors	11,379	11,656	11,708	12,317	12,980
Other Current Liab	578	855	1,987	1,560	1,620
LT Debt	10,740	11,109	9,009	4,409	847
Other LT Liabilities	1,095	1,378	1,068	1,098	1,098
Shareholder's Equity	70,148	76,309	89,268	105,704	123,997
Minority Interests	3,397	3,669	4,442	5,422	6,512
Total Cap. & Liab.	105,781	109,514	122,018	135,046	148,053
Non-Cash Wkg. Capital	9,998	11,007	16,583	18,329	18,822
Net Cash/(Debt)	(14,713)	(9,582)	(3,077)	7,443	19,420
Debtors Turn (avg days)	32.2	38.7	43.2	43.2	43.2
Creditors Turn (avg days)	44.5	40.9	36.0	36.0	36.0
Inventory Turn (avg days)	7.9	7.9	8.7	8.7	8.7
Asset Turnover (x)	0.5	0.5	0.6	0.7	0.6
Current Ratio (x)	1.3	1.7	2.2	2.6	3.5
Quick Ratio (x)	0.6	0.9	1.2	1.6	2.2
Net Debt/Equity (X)	0.2	0.1	0.0	CASH	CASH
Net Debt/Equity ex MI (X)	0.2	0.1	0.0	CASH	CASH
Capex to Debt (%)	24.7	30.2	67.9	77.1	373.7
Z-Score (X)	5.0	5.5	6.1	6.1	6.9

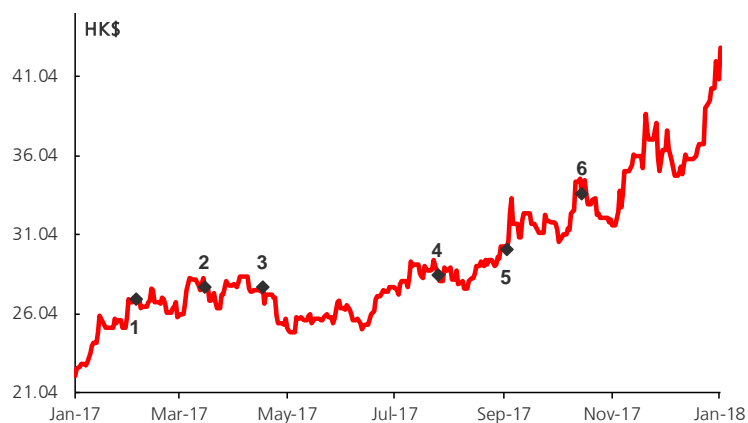
Source: Company, DBS Vickers

Cash Flow Statement (RMB m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	10,086	11,699	20,853	26,447	29,435
Dep. & Amort.	4,459	4,753	5,017	5,268	5,505
Tax Paid	(3,071)	(2,320)	(4,852)	(6,154)	(6,849)
Assoc. & JV Inc/(loss)	137	59	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(225)	(1,317)	(2,718)	(1,299)	(533)
Other Operating CF	(2,442)	(683)	(513)	(683)	(730)
Net Operating CF	8,944	12,191	17,787	23,580	26,828
Capital Exp.(net)	(4,736)	(4,722)	(9,200)	(6,900)	(6,900)
Other Invts.(net)	1,566	545	0	0	0
Invts in Assoc. & JV	(1,801)	(872)	0	0	0
Div from Assoc & JV	9	4	0	0	0
Other Investing CF	(7,757)	492	513	683	730
Net Investing CF	(12,719)	(4,552)	(8,687)	(6,217)	(6,170)
Div Paid	(3,918)	(2,558)	(2,650)	(6,853)	(8,691)
Chg in Gross Debt	(770)	(3,538)	(2,100)	(4,600)	(7,100)
Capital Issues	0	0	0	0	0
Other Financing CF	257	(49)	0	0	0
Net Financing CF	(4,431)	(6,145)	(4,750)	(11,453)	(15,791)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(8,206)	1,494	4,350	5,910	4,867
Opg CFPS (RMB)	1.73	2.55	3.87	4.69	5.16
Free CFPS (RMB)	0.79	1.41	1.62	3.15	3.76

Source: Company, DBS Vickers

Target Price & Ratings History – H Share

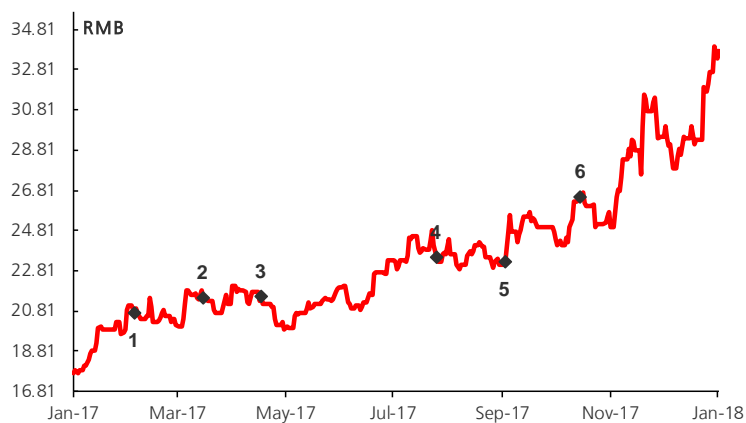


S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	13 Feb 17	26.95	30.02	BUY
2:	24 Mar 17	27.70	32.20	BUY
3:	26 Apr 17	27.70	32.20	BUY
4:	03 Aug 17	28.45	34.09	BUY
5:	11 Sep 17	30.10	35.80	BUY
6:	24 Oct 17	33.65	40.00	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBSVHK
 Analyst: Addison Dai

Target Price & Ratings History – A Share



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	13 Feb 17	20.74	24.09	BUY
2:	24 Mar 17	21.50	25.44	BUY
3:	26 Apr 17	21.52	25.44	BUY
4:	03 Aug 17	23.48	25.44	BUY
5:	11 Sep 17	23.26	27.97	BUY
6:	24 Oct 17	26.48	31.23	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBSVHK
 Analyst: Addison Dai

DBSVHK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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Sources for all charts and tables are DBS Vickers unless otherwise specified.

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