



Rating
Hold

Asia
China

Resources
Metals & Mining

Company
Zhong Ke San Huan

Reuters 000970.SZ Bloomberg 000970 CH Exchange SHZ Ticker 000970

Date
18 August 2017

Forecast Change

Price at 17 Aug 2017 (CNY)	17.02
Price target - 12mth (CNY)	14.00
52-week range (CNY)	18.78 - 12.19
HANG SENG INDEX	27,344

Results missed on higher raw materials prices

Hard to pass through raw materials cost; maintain Hold rating

ZKSH released its earnings with bottom line of RMB153m, almost flattish yoy, only achieving 38% of DBe and consensus, respectively. The company mainly attributes this to raw materials price hikes during 1H. For instance, Praseodymium and Neodymium metal price increased by 24% from early 2017 to Jun 2017. Given stable demand growth in NdFeB magnets, it is hard for the company to pass through the entire cost hike to customers. We revise down our earnings accordingly and cut our target price by 5% . Maintain Hold.

Margin pressure on strong momentum in rare earth prices

We expect strong rare earth prices momentum to continue thanks to government's quota control and crackdowns on illegal mines. SRB buying earlier this year also helped with some individual elements' demand supply situations. On the other hand, although we have decent magnets demand growth as a result of emerging EV growth, overall utilization rate across high-end magnets are still below 80%, not to mention 50%-60% for low end plants. We thus envision margin pressure will remain.

Valuation and risks

To reflect higher raw material cost, we revise down our 2017 and 2018 earnings by 11% and 8%, respectively. We derived our target price of RMB14.0 (previously RMB 14.7) for Zhong Ke San Huan via a DCF methodology with a WACC of 8.8%. We adopt 10.6% as the cost of equity for San Huan, reflecting a risk-free rate of 3.9%, a market risk premium of 5.6% and a beta of 1.2. Risks: higher/lower raw materials cost.

Valuation & Risks

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Key changes

TP	14.70 to 14.00	↓	-4.8%
Sales (FYE)	4,092 to 4,019	↓	-1.8%
Op prof margin (FYE)	14.4 to 12.9	↓	-10.4%
Net profit (FYE)	398.4 to 354.5	↓	-11.0%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	15.6	20.6	6.2
HANG SENG INDEX	3.3	8.1	19.9

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	8.4
Net debt/equity (%)	-34.7
Book value/share (CNY)	4.09
Price/book (x)	4.2
Net interest cover (x)	-
Operating profit margin (%)	12.9

Source: Deutsche Bank



Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	3,502.3	3,540.9	4,019.0	4,763.7	5,524.5
EBITDA (CNYm)	505.8	550.8	626.8	825.8	982.5
EBIT(CNYm)	405	450	518	712	865
Reported EPS FD(CNY)	0.26	0.30	0.33	0.46	0.56
Reported NPAT (CNYm)	274.8	316.6	354.5	487.1	592.3
DB EPS growth (%)	–	15.2	12.0	37.4	21.6
DB EPS FD(CNY)	0.26	0.30	0.33	0.46	0.56
OLD DB EPS FD(CNY)	0.26	0.30	0.37	0.49	–
% Change	0.0%	0.0%	-11.0%	-7.6%	–
PER (x)	68.6	47.1	51.1	37.2	30.6
EV/EBITDA (x)	35.2	24.9	26.8	20.3	17.0
DPS (net) (CNY)	0.09	0.10	0.11	0.15	0.18
Yield (net) (%)	0.5	0.7	0.6	0.9	1.1

Source: Deutsche Bank estimates, company data



Figure 1: ZKSH result summary

	1H17	1H16	YoY	2H16	HoH	1Q17	2Q17	QoQ	FY17 DBe	% of DBe	Cons.	% of Cons.
Revenue	1,776	1,670	6.3%	1,871	-5.1%	797	979	22.9%	4,092	43.4%	3,977	44.7%
COGS	1,349	1,252	7.8%	1,435	-6.0%	615	735	19.6%	3,094	43.6%	2,962	45.5%
GP	427	419	1.9%	435	-1.9%	182	245	34.3%	998	42.8%	1,015	42.0%
SG&A	196	211	-7.1%	193	1.4%	78	117	50.3%	409	47.8%	408	47.9%
OP	231	208	11.1%	289	-20.0%	104	127	22.3%	588	39.3%	607	38.1%
NPAT	153	153	0.3%	164	-6.6%	73	80	10.7%	398	38.4%	400	38.3%
CFO	(17)	238	-107.3%	108	-116.1%	26	(43.6)	-266.7%	491	-3.5%		
GPM	24.0%	25.1%		23.3%		22.9%	25.0%		24.4%		25.5%	
SG&A % of revenue	11.0%	12.6%		10.3%		9.8%	12.0%		10.0%		10.3%	
Effective tax rate	24.1%	23.8%		26.9%		23.3%	24.8%		25.5%			
Gearing ratio	-27.6%	-33.1%		-32.2%		-34.2%	-27.6%		-34.7%			
AR days	238	211		216		52	52		100			
AP days	150	106		95		168	144		51			
Inventory days	349	286		240		161	160		120			

Source: Deutsche Bank, Bloomberg Finance LP, company info. Note: FY17 DBe data show previous DB estimates.



Model updated: 18 August 2017

Running the numbers

Asia
China
Metals & Mining

Zhong Ke San Huan

Reuters: 000970.SZ Bloomberg: 000970 CH

Hold

Price (17 Aug 17) CNY 17.02

Target Price CNY 14.00

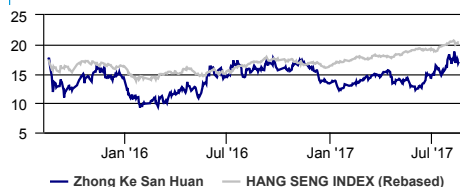
52 Week range CNY 12.19 - 18.78

Market cap (m) CNYm 18,130
USDm 2,718.6

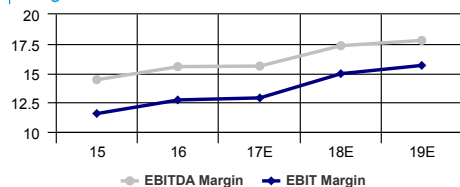
Company Profile

Beijing Zhong Ke San Huan High-Tech Co., Ltd. is a global leading NdFeB magnets producer with 16kt NdFeB magnets capacity by 2014 (ranked No.1 globally), of which 13kt belongs to high-end NdFeB. Zhong Ke San Huan's magnetic products are mainly applied in auto motors, VCM, wind turbine, energy-saving motors and consumer electronics, etc.

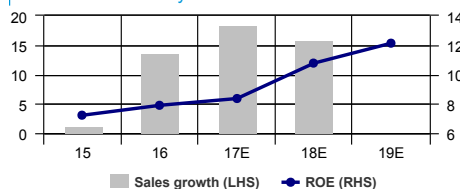
Price Performance



Margin Trends



Growth & Profitability



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Fiscal year end 31-Dec 2015 2016 2017E 2018E 2019E

Financial Summary

DB EPS (CNY)	0.26	0.30	0.33	0.46	0.56
Reported EPS (CNY)	0.26	0.30	0.33	0.46	0.56
DPS (CNY)	0.09	0.10	0.11	0.15	0.18
BVPS (CNY)	3.7	3.9	4.1	4.4	4.8
Weighted average shares (m)	1,065	1,065	1,065	1,065	1,065
Average market cap (CNYm)	18,850	14,917	18,130	18,130	18,130
Enterprise value (CNYm)	17,782	13,737	16,794	16,784	16,708

Valuation Metrics

P/E (DB) (x)	68.6	47.1	51.1	37.2	30.6
P/E (Reported) (x)	68.6	47.1	51.1	37.2	30.6
P/BV (x)	3.84	3.45	4.16	3.87	3.57
FCF Yield (%)	1.5	1.6	1.7	1.4	2.1
Dividend Yield (%)	0.5	0.7	0.6	0.9	1.1
EV/Sales (x)	5.1	3.9	4.2	3.5	3.0
EV/EBITDA (x)	35.2	24.9	26.8	20.3	17.0
EV/EBIT (x)	43.9	30.5	32.4	23.6	19.3

Income Statement (CNYm)

Sales revenue	3,502	3,541	4,019	4,764	5,524
Gross profit	902	954	1,069	1,326	1,563
EBITDA	506	551	627	826	982
Depreciation	101	100	109	114	118
Amortisation	0	0	0	0	0
EBIT	405	450	518	712	865
Net interest income/(expense)	55	64	6	7	8
Associates/affiliates	-14	0	10	27	44
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	-6	-7	34	33	32
Profit before tax	440	507	568	780	949
Income tax expense	109	129	145	199	242
Minorities	56	61	69	94	115
Other post-tax income/(expense)	0	0	0	0	0
Net profit	275	317	354	487	592
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	275	317	354	487	592

Cash Flow (CNYm)

Cash flow from operations	434	346	465	406	526
Net Capex	-143	-113	-154	-149	-149
Free cash flow	291	233	311	258	378
Equity raised/(bought back)	0	0	0	0	0
Dividends paid	-137	-121	-117	-161	-195
Net inc/(dec) in borrowings	-243	-28	0	0	0
Other investing/financing cash flows	175	-94	6	7	8
Net cash flow	86	-9	200	105	190
Change in working capital	0	0	0	0	0

Balance Sheet (CNYm)

Cash and other liquid assets	1,683	1,616	1,840	1,945	2,135
Tangible fixed assets	879	921	945	984	1,018
Goodwill/intangible assets	63	67	63	60	57
Associates/investments	152	341	341	341	341
Other assets	2,545	2,645	2,776	3,159	3,558
Total assets	5,321	5,590	5,966	6,488	7,109
Interest bearing debt	82	55	55	55	55
Other liabilities	660	692	762	864	972
Total liabilities	741	747	817	918	1,027
Shareholders' equity	3,895	4,121	4,358	4,685	5,082
Minorities	685	722	791	885	1,000
Total shareholders' equity	4,580	4,843	5,149	5,570	6,082
Net debt	-1,601	-1,561	-1,785	-1,890	-2,080

Key Company Metrics

Sales growth (%)	nm	1.1	13.5	18.5	16.0
DB EPS growth (%)	na	15.2	12.0	37.4	21.6
EBITDA Margin (%)	14.4	15.6	15.6	17.3	17.8
EBIT Margin (%)	11.6	12.7	12.9	15.0	15.7
Payout ratio (%)	33.0	33.0	33.0	33.0	33.0
ROE (%)	7.2	7.9	8.4	10.8	12.1
Capex/sales (%)	4.4	3.2	3.8	3.1	2.7
Capex/depreciation (x)	1.5	1.1	1.4	1.3	1.3
Net debt/equity (%)	-35.0	-32.2	-34.7	-33.9	-34.2
Net interest cover (x)	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Zhong Ke San Huan	000970.SZ	16.39 (CNY) 18 Aug 2017	NA

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Historical recommendations and target price. Zhong Ke San Huan (000970.SZ)

(as of 08/17/2017)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	08/27/2015	Buy, Target Price Change CNY 17,00	James Kan	3.	06/21/2016	Downgraded to Hold, Target Price Change CNY 14,20	James Kan
2.	03/20/2016	Buy, Target Price Change CNY 14,50	James Kan	4.	10/27/2016	Hold, Target Price Change CNY 14,70	James Kan



Equity Rating Key

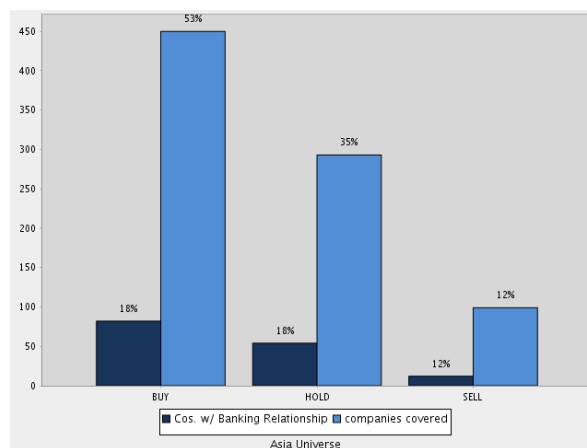
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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

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