



Rating
Hold

Asia
China

Energy
Chemicals

Company
QSLI

Reuters 000792.SZ Bloomberg 000792 CH Exchange SHZ Ticker 000792

Date
5 September 2017

Forecast Change

Price at 4 Sep 2017 (CNY)	11.65
Price target - 12mth (CNY)	11.66
52-week range (CNY)	21.29 - 9.55
Shenzhen Index	2,046

Difficult market ahead, but debt-to-equity swap plan holding up valuation

Core earnings break even; challenging market ahead but valuation holding up

We expect a challenging operating environment for QSLI, particularly for its chemical integration project, which overhangs QSLI's performance. The company showed signs of improvement in operations QoQ in 2Q17 and reached operational breakeven; if we strip out one-off items (i.e., asset impairment), QSLI's core earnings entered positive territory with a profit of RMB23mn in 2Q17 vs. a loss of RMB210mn in 1Q17, thanks to an improved transportation situation with higher potash sales volume QoQ. 2H17 should see an improvement HoH, with higher sales volume of potash/lithium, while the potential debt-to-equity swap may be the next catalyst for the share price; however, shaky market conditions plus difficult financials with higher DD&A charges could offset the positives. We see a balanced risk-reward profile and keep our Hold rating and TP of RMB11.66/share.

Debt-to-equity swap plan to support share price; 1H17 net gearing at 114%

The potential restructuring of debt should support QSLI's valuation, with two restructurings planned: 1) QSLI has proposed a debt-to-equity swap; and 2) a new bond issuance. EBIT broke even at RMB174mn in 1H17, while operating cash flow was RMB401mn, down 27% YoY. We see limited balance sheet improvement, with a net gearing of 114% in 1H17 (vs. 115% in 1H16/125% in FY16). On the other hand, QSLI signed a debt-to-equity swap MOU with Qinghai SASAC and CCB, forming a deleveraging fund of RMB20bn to facilitate the debt-to-equity swap process. The details of the plan are still under negotiation. As per our analysis, the debt-to-equity swap will likely be accretive for both ROE and EPS; under our scenario 1, which uses our TP as an exercise price, FY18E ROE is enhanced by +1.9%pts and EPS by +135% (see our analysis table for details).

Recap of 1H17 earnings: sluggish on both ends

QSLI posted 1H17 results on 30 August with a net loss of RMB523mn (EPS of RMB-0.188/share), down 243% YoY and in line with the preliminary results announcement. The sluggish 1H17 performance was mainly attributed to 1) asset impairment of RMB448mn on urea/methanol/inventory; 2) a 25% YoY decline in potash sales volume; 3) a 19% YoY dip in potash ASP; and 4) higher DD&A on magnesium integration and Haina PVC projects. Stripping out the one-off items, 1H17 core net loss would have been RMB142mn vs. 1H16 core net profit of RMB347mn. Looking at the cash earnings, however, the EBITDA to net interest expenses was 2.0x in 1H17, while net gearing stood at 114%.

- Sluggish potash performance: the segment revenue declined 39% YoY to RMB2.3bn, while GPM fell 7%pts YoY to 66%, due to 1) a 25% YoY

Valuation & Risks

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Key changes

Sales (FYE)	8,757 to 8,272	↓	-5.5%
Op prof margin (FYE)	18.5 to 13.6	↓	-26.2%
Net profit (FYE)	446.8 to -208.6	↓	-146.7%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-1.8	-17.7	-41.1
Shenzhen Index	5.3	9.4	-2.6

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	-0.9
Net debt/equity (%)	155.9
Book value/share (CNY)	8.73
Price/book (x)	1.3
Net interest cover (x)	1.1
Operating profit margin (%)	13.6

Source: Deutsche Bank



decline in sales volume (by 626kton) to 1,847kton, from 2,474kton in 1H16, attributed to delivery delays caused by transportation regulations beginning 4Q16; and 2) a 19% YoY dip in potash ASP to RMB1,284/ton (from RMB1,588/ton), excluding tax and transportation cost.

- The worse-than-expected loss in the chemical segment was due to 1) a higher DD&A charge on magnesium integration and Haina PVC projects starting operations; 2) impairment provisions for inventory and urea and methanol plants; and 3) a dip in the overall utilization rate to below 70%, influenced by an environmental inspection. This offset the strong performance in lithium, where revenue increased 4x to RMB172mn in 1H17 (despite a GPM of 59%). Looking ahead, QSLI expects to double lithium carbonate production to c.4kton in 2H17.

Earnings, valuation and risks; maintaining Hold

We cut our FY17E/18E EPS to RMB-0.07/0.10, down RMB0.19/0.20 on asset impairments, higher DD&A charges, and lower potash sales volume. However, we keep our DCF-derived TP at RMB11.66 (assuming a 6.6% WACC and 2% terminal growth), which implies 1.2x P/B in 17-18E; we believe the risks and rewards are balanced at a current valuation of 1.2x 17E P/B vs 1.1% 17E ROE, supported by a potentially ROE-/EPS-accretive debt-to-equity swap plan. Key downside risks: 1) sluggish chemical prices and soft demand could lead to lower product sales; and 2) unfavorable government policy. Key upside risks: 1) better-than-expected potash prices; and 2) faster-than-expected demand growth.

Figure 1: QSLI debt-to-equity swap scenario analysis

Summary	Unit	Scenario 1	Scenario 2	Scenario 3	Scenario 4
		DB Target Price	Current share price	+30% of current share prices	-30% of current share prices
Swap @ share price	RMB/share	11.66	11.65	17.475	8.155
EPS enhancement	%	+135%	+135%	+169%	+102%
ROE enhancement	%	+1.9%pts	+1.9%pts	+1.9%pts	+1.9%pts
Original number of shares	mn of shares	2,786			
Number of new shares	mn of shares	1,715	1,717	1,144	2,452
After swap number of shares	mn of shares	4,501	4,503	3,931	5,239

Source: Company data, Deutsche Bank estimates

Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	10,882.2	10,364.1	8,271.8	9,006.9	10,650.7
EBITDA (CNYm)	3,651.6	3,172.2	3,725.7	4,387.8	5,684.9
Reported NPAT (CNYm)	559.0	341.3	-208.6	268.5	953.4
Reported EPS FD(CNY)	0.23	0.12	-0.07	0.10	0.34
DB EPS FD(CNY)	0.23	0.12	-0.07	0.10	0.34
DB EPS growth (%)	-	-47.2	-	-	255.1
Price/Book (x)	3.1	2.2	1.3	1.3	1.3
PER (x)	105.2	157.9	-	120.9	34.0
EV/EBITDA (x)	24.9	29.1	18.8	15.8	11.9
DPS (net) (CNY)	0.02	0.01	0.00	0.01	0.04
Yield (net) (%)	0.1	0.1	0.0	0.1	0.3

Source: Deutsche Bank estimates, company data



Debt-to-equity scenario analysis

Figure 2: Debt-to-equity scenario analysis for FY18E EPS and ROE

Summary	Unit	Scenario 1	Scenario 2	Scenario 3	Scenario 4
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Interest saving analysis		Scenario 1	Scenario 2	Scenario 3	Scenario 4
Debt-to-equity swap amount	RMBmn	20,000			
Interest rate	%	5%			
Interest saving	RMBmn	1,000			
Tax rate	%	25%			
Potential income accretion	RMBmn	750			
FY18E original net income	RMBmn	268			
FY18E after swap net income	RMBmn	1,018			
FY18E original EPS	RMB/share	0.10	0.10	0.10	0.10
FY18E after swap EPS	RMB/share	0.23	0.23	0.26	0.19
EPS enhancement	%	+135%	+135%	+169%	+102%
ROE scenario analysis		Scenario 1	Scenario 2	Scenario 3	Scenario 4
FY17E shareholders equity	RMBmn	24,316			
FY18E original shareholders equity	RMBmn	24,555			
FY18E original ROE	%	1.1%			
FY18 after swap shareholders equity	RMBmn	44,316			
FY18 after swap ROE	%	3.0%	3.0%	3.0%	3.0%
ROE enhancement	%	+1.9%pts	+1.9%pts	+1.9%pts	+1.9%pts

Source: Company data, Deutsche Bank estimates

Key financial data

Figure 3: 1H17 income statement

RMB million	1H13	2H13	1H14	2H14	1H15	2H15	1H16	2H16	1H17	1H17 YoY	1H17 HoH
Revenue	4,129	3,966	4,204	6,271	4,317	6,565	5,273	5,091	5,065	-4%	-1%
COGS	(1,872)	(2,059)	(2,049)	(3,028)	(2,225)	(2,967)	(2,594)	(3,347)	(3,542)	37%	6%
Gross Profit	2,257	1,907	2,155	3,242	2,092	3,598	2,680	1,744	1,524	-43%	-13%
SG&A	(705)	(920)	(830)	(1,322)	(908)	(1,640)	(1,357)	(572)	(674)	-50%	18%
Operating profit	1,552	987	1,324	1,920	1,183	1,958	1,323	1,172	849	-36%	-28%
Other Income/(loss)	(235)	(254)	(465)	(334)	(287)	(1,080)	(297)	(642)	(675)	127%	5%
EBIT	1,318	732	859	1,586	896	878	1,025	529	174	-83%	-67%
Interest expense	(262)	(358)	(310)	(415)	(449)	(563)	(584)	(481)	(660)	13%	37%
Pretax income	1,056	375	549	1,171	447	316	442	48	(486)	NM	NM
Tax expense	(163)	(202)	(112)	(277)	(106)	(112)	(78)	(202)	(35)	-55%	-83%
Net profit	893	173	437	894	341	222	364	(154)	(521)	-243%	238%
NP attributable to shareholders	822	230	429	873	361	198	329	12	(523)	NM	NM
EPS	0.52	0.14	0.27	0.55	0.23	0.12	0.18	0.01	(0.19)	NM	NM
GPM%	55%	48%	51%	52%	48%	55%	51%	34%	30%	-21% ppts	-4% ppts
OPM%	38%	25%	32%	31%	27%	30%	25%	23%	17%	-8% ppts	-6% ppts
NIM%	22%	4%	10%	14%	8%	3%	7%	-3%	-10%	-17% ppts	-7% ppts
SG&A as % of Revenue	17%	23%	20%	21%	21%	25%	26%	11%	13%	-12% ppts	2% ppts
Effective tax rate	15%	54%	20%	24%	24%	36%	18%	422%	-7%	-25% ppts	-429% ppts

Source: Company data, Deutsche Bank

Key operating data



Figure 4: Potash operating details

Potassium Chloride	1H16	1H17	1H17 YoY %
Revenue (RMB mn)	3,929	2,372	-40%
ASP(RMB/t)	1,588	1,284	-19%
Production (th tonne)	1,925	1,977	3%
Sales (th tonne)	2,474	1,847	-25%
GPM%	73%	66%	-8% ppts

Source: Company data, Deutsche Bank

Comps

Figure 5: Global fertilizer comps

Name	Reuters Ticker	DB Rating	Trading Ccy	01-Sep Price	Mkt Cap (USD mn)	P/E (x)		P/B (x)		ROE (%)		Dvd yield (%)		EV/EBITDA (x)		ROIC (%)	
						FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
China - H Listed																	
China BlueChem	3983.HK	Buy	HKD	2.35	1,355	19.5	9.9	0.7	0.6	3.4	6.5	2.6	5.1	2.4	1.6	6.1	11.0
Sinofert	0297.HK	Hold	HKD	1.10	979	237.2	21.9	0.8	0.7	0.3	3.4	0.0	1.2	6.0	3.3	-2.2	2.9
Weighted average						99.8	13.9	0.7	0.7	1.9	4.7	1.9	3.6	4.9	3.5	2.3	6.8
China - A Listed																	
OSLI	000792.SZ	Hold	CNY	11.71	4,226	NA	121.5	1.2	1.2	-0.8	1.0	NA	0.1	10.3	8.7	-29%	27%
Shandong Kingenta	002470.SZ	NR	CNY	8.17	3,873	19.0	16.1	2.5	2.3	14.1	15.4	1.6	1.9	14.1	11.3	NA	NA
Yunnan Yuntianhua	600096.SS	NR	CNY	8.02	1,595	NA	100.3	2.8	2.7	-2.7	3.0	NA	NA	12.9	12.8	NA	NA
Hualu-Hengsheng	600426.SS	NR	CNY	11.00	2,683	15.7	12.0	1.8	1.6	12.0	13.8	1.0	1.3	8.9	7.9	NA	NA
Shenzhen Batian	002170.SZ	NR	CNY	7.02	940	21.9	15.3	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Hubei Xingfa	600141.SS	NR	CNY	16.34	1,231	34.5	28.6	1.3	1.3	4.9	5.8	0.8	0.9	10.1	9.5	NA	NA
Weighted average						10.8	44.9	1.5	1.4	5.8	7.5	1.2	1.6	9.2	8.0	-0.3	0.3
Global (ex-HK/China)																	
Industries Qatar	IQCD.OA	Buy	QAR	91.00	14,964	14.2	12.9	1.5	1.3	10.9	10.8	4.4	4.4	27.4	21.3	2.7	3.1
Potash Corp	POT.N	Hold	USD	17.28	14,517	28.2	25.4	1.7	1.7	5.9	6.7	NA	NA	13.3	11.7	NA	NA
Agrium	AGU.CN	NR	CAD	121.04	13,408	19.9	16.4	2.1	2.0	10.8	12.3	3.6	3.7	10.5	9.2	NA	NA
Ma'aden	1211.SE	Sell	SAR	50.50	15,734	82.3	44.5	2.3	2.2	2.8	5.0	0.0	0.0	23.0	17.2	2.5	3.4
Yara	YAR.OL	Hold	NOK	329.20	11,547	20.3	16.2	1.2	1.1	5.9	7.1	2.7	3.0	9.3	8.1	5.5	6.3
PTT GC	PTTGC.BK	Buy	THB	76.00	10,321	11.8	11.8	1.3	1.2	11.4	10.9	4.2	4.3	7.0	6.3	11.7	12.4
Uralkali	URKAQ.L	Sell	USD	138.20	5,875	8.7	NA	4.0	NA	60.3	NA	0.0	NA	8.3	NA	13.1	NA
PHOSAGRO	PHCRq.L	Hold	USD	14.20	5,517	9.5	9.0	3.1	2.6	35.9	31.1	5.3	5.5	7.0	6.5	19.4	18.7
K+S	SDFGn.DE	Sell	EUR	20.43	4,644	20.6	14.7	0.8	0.8	4.1	5.6	2.2	3.4	11.4	9.1	3.4	4.3
Coromandel Int'l	CORF.BO	Buy	INR	437.55	1,168	16.4	21.0	3.2	3.9	18.0	19.7	1.9	1.4	10.1	12.7	12.5	14.0
Weighted average						26.1	17.8	2.1	1.5	13.6	9.3	2.7	2.4	14.1	10.6	9.8	7.1

Source: Bloomberg Finance L.P., Deutsche Bank estimates; Note: Bloomberg consensus estimates for non-rated (NR) companies



Model updated: 04 September 2017

Running the numbers

Asia

China

Chemicals

QSLI

Reuters: 000792.SZ Bloomberg: 000792 CH

Hold

Price (4 Sep 17) CNY 11.65

Target Price CNY 11.66

52 Week range CNY 9.55 - 21.29

Market cap (m) CNYm 27,794
USDm 4,225.9

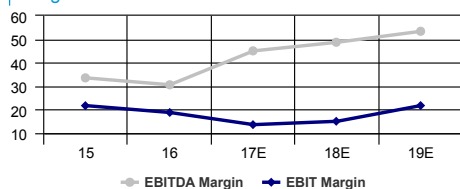
Company Profile

QSLI is the largest potash fertilizer (MOP) manufacturer in China with 3.5mntpa of capacity and its new 1.5mntpa capacity is expected to come on-stream for a production trial in 2H16, which would boost capacity by 43%.

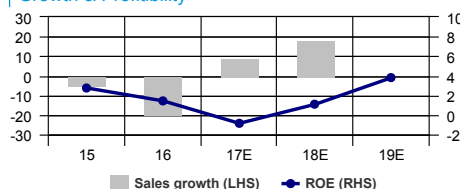
Price Performance



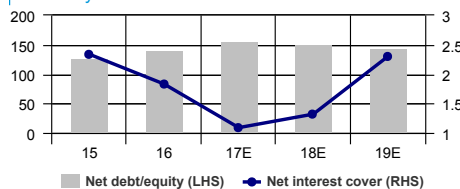
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec

Financial Summary

	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.23	0.12	-0.07	0.10	0.34
Reported EPS (CNY)	0.23	0.12	-0.07	0.10	0.34
DPS (CNY)	0.02	0.01	0.00	0.01	0.04
BVPS (CNY)	8.2	8.8	8.7	8.8	9.1
Weighted average shares (m)	2,410	2,786	2,786	2,786	2,786
Average market cap (CNYm)	58,814	53,884	27,794	27,794	27,794
Enterprise value (CNYm)	90,958	92,178	70,023	69,146	67,475

Valuation Metrics

P/E (DB) (x)	105.2	157.9	nm	120.9	34.0
P/E (Reported) (x)	105.2	157.9	nm	120.9	34.0
P/BV (x)	3.12	2.17	1.33	1.32	1.28
FCF Yield (%)	nm	nm	nm	5.6	7.4
Dividend Yield (%)	0.1	0.1	0.0	0.1	0.3
EV/Sales (x)	8.4	8.9	8.5	7.7	6.3
EV/EBITDA (x)	24.9	29.1	18.8	15.8	11.9
EV/EBIT (x)	38.5	47.2	62.0	50.9	29.1

Income Statement (CNYm)

Sales revenue	10,882	10,364	8,272	9,007	10,651
Gross profit	5,690	4,424	3,703	4,243	5,685
EBITDA	3,652	3,172	3,726	4,388	5,685
Depreciation	1,249	1,182	2,535	2,965	3,299
Amortisation	38	39	62	64	67
EBIT	2,365	1,951	1,129	1,358	2,319
Net interest income/(expense)	-1,012	-1,065	-1,036	-1,029	-1,008
Associates/affiliates	0	0	0	0	0
Exceptionals/extraordinary	-1,151	-956	-448	0	0
Other pre-tax income/(expense)	560	560	56	56	56
Profit before tax	762	489	-299	385	1,367
Income tax expense	218	280	-171	220	782
Minorities	-15	-132	80	-104	-368
Other post-tax income/(expense)	0	0	0	0	0
Net profit	559	341	-209	268	953
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	559	341	-209	268	953

Cash Flow (CNYm)

Cash flow from operations	753	2,028	731	4,232	4,616
Net Capex	-5,119	-3,321	-2,800	-2,400	-2,200
Free cash flow	-4,366	-1,293	-2,069	1,832	2,416
Equity raised/(bought back)	4,862	1,482	0	0	0
Dividends paid	-2,579	-2,311	-1,036	-1,059	-1,113
Net inc/(dec) in borrowings	6,588	-1,966	-1,627	-482	-602
Other investing/financing cash flows	1,227	944	0	0	0
Net cash flow	5,732	-3,144	-4,732	291	701
Change in working capital	-3,236	-1,597	-2,774	8	-343

Balance Sheet (CNYm)

Cash and other liquid assets	9,031	5,813	1,081	1,372	2,073
Tangible fixed assets	61,594	65,680	65,893	65,283	64,142
Goodwill/intangible assets	767	816	806	787	761
Associates/investments	563	617	617	617	617
Other assets	8,759	10,020	9,701	10,602	12,105
Total assets	80,713	82,946	78,098	78,660	79,698
Interest bearing debt	40,166	42,876	41,999	41,517	40,914
Other liabilities	16,065	13,698	9,855	10,765	11,924
Total liabilities	56,231	56,574	51,854	52,281	52,839
Shareholders' equity	22,911	24,524	24,316	24,555	25,403
Minorities	1,572	1,847	1,928	1,824	1,456
Total shareholders' equity	24,482	26,372	26,243	26,379	26,859
Net debt	31,135	37,063	40,918	40,145	38,842

Key Company Metrics

Sales growth (%)	nm	-4.8	-20.2	8.9	18.3
DB EPS growth (%)	na	-47.2	na	na	255.1
EBITDA Margin (%)	33.6	30.6	45.0	48.7	53.4
EBIT Margin (%)	21.7	18.8	13.6	15.1	21.8
Payout ratio (%)	8.9	10.9	nm	11.0	11.0
ROE (%)	2.8	1.4	-0.9	1.1	3.8
Capex/sales (%)	47.1	32.0	33.8	26.6	20.7
Capex/depreciation (x)	4.0	2.7	1.1	0.8	0.7
Net debt/equity (%)	127.2	140.5	155.9	152.2	144.6
Net interest cover (x)	2.3	1.8	1.1	1.3	2.3

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
QSLI	000792.SZ	11.65 (CNY) 4 Sep 2017	NA

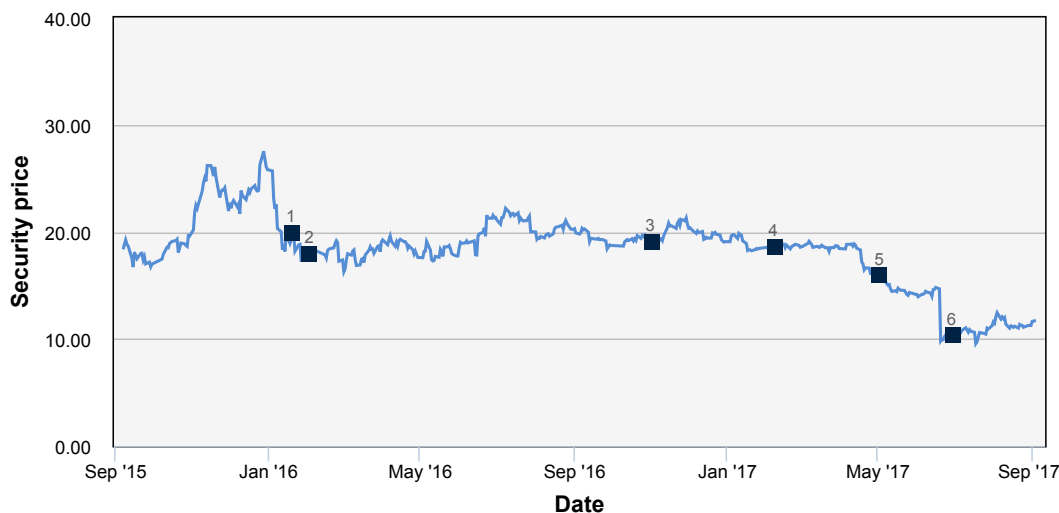
*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg, and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqs>. Aside from within this report, important conflict disclosures can also be found at <https://gm/db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Vitus Leung

Historical recommendations and target price. QSLI (000792.SZ)

(as of 09/04/2017)



Current Recommendations

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

** Analyst is no longer at Deutsche Bank

1.	01/20/2016	Hold, Target Price Change CNY 22,20	Vitus Leung	4.	02/08/2017	Hold, Target Price Change CNY 19,10	Vitus Leung
2.	02/03/2016	Hold, Target Price Change CNY 20,00	Vitus Leung	5.	05/03/2017	Hold, Target Price Change CNY 17,50	Vitus Leung
3.	11/02/2016	Hold, Target Price Change CNY 18,50	Vitus Leung	6.	06/30/2017	Hold, Target Price Change CNY 11,66	Vitus Leung



Equity Rating Key

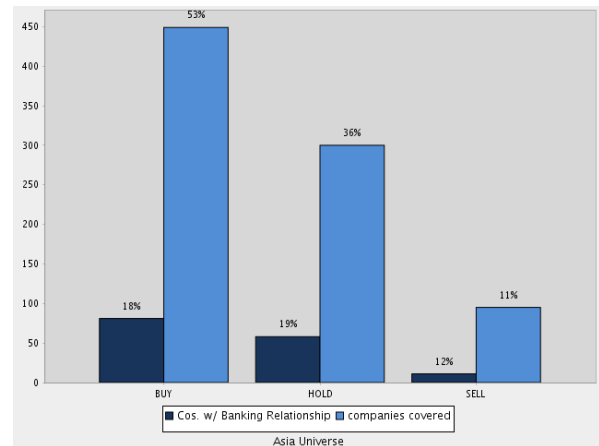
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Equity rating dispersion and banking relationships





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