

Conch Cement [0914.HK; 600585.CH]

Temporary Suspension of Tongling Conch Expected To Have Limited Impact

We believe the temporary production suspension of Tongling Conch will have a very limited impact on earnings this year. Since Tongling Conch is a major taxpayer in Tongling city, we believe the municipal government will work closely with Tongling Conch to sort out the environmental protection issues. We maintain our **BUY** rating and the H-share target price of HK\$59.50, based on 2.5x 2018E PBR (A-share target price: RMB45.10). Meanwhile, the two factors capping the share price performance of Conch Cement are fading, i.e. (i) the relatively cheap valuation of Conch Venture (0586.HK), and (ii) the relatively deep share price discount of Conch Cement-A.

Investment Highlights

No violation of laws by Tongling Conch. In May, Tongling Conch, a wholly owned subsidiary of Conch Cement, received a notice jointly issued by the the Tongling Environmental Protection Bureau and Tongling Port and Shipping (Local Maritime) Bureau to suspend the operations of Tongling Conch Pier. The pier is located inside the Class B reserve at the intake point of the Tongling Water Treatment Plant. Since the pier is an important channel for Tongling Conch to ship cement and clinker products to its customers, the suspension of the pier also led a production halt of Tongling Conch in late May. The suspension order is mainly due to a special action plan launched by the central government in March, which requires the clearance and upgrading of Class A and Class B drinking water source reserves. Tongling Conch emphasized that it had obtained all the necessary licences and that the suspension of the Tongling Conch Pier was not due to any violation of laws.

Very small financial impact. Although there is no clear timetable for resuming operations, we believe the financial impact on Conch Cement is likely to be small. First of all, Tongling Conch accounted for 5.52% of Conch Cement's total net profit in 2017. We don't expect the production halt to last very long. As Tongling Conch is a major taxpayer in Tongling city, we believe the municipal government will work closely with Tongling Conch to sort out the environmental protection issues. Meanwhile, Conch Cement has organized inspections and reviews of the rest of its production plants along the Yangtze River. No similar situation or risks exist for its other production plants.

Two factors capping share price performance fading. In the past few months, we mentioned two technical factors affecting the share price performance of Conch Cement: (i) the relatively cheap valuation of Conch Venture and (ii) the relatively deep share price discount of Conch Cement-A. These two factors have been fading. For (i), the attributable market cap of Conch Cement/market cap of Conch Venture has dropped from >110% to about 80% (Figure 2), which is more in line with the profit contribution now (Conch Cement contributed 84% of net profit of Conch Venture in 2017). Therefore Conch Venture is no longer a cheap proxy for Conch Cement. For (ii), the share price premium of Conch Cement-H over Conch Cement-A has narrowed from >17% at end-April to currently about 9%, closer to the 3-year average of 6.4%.

Y/E Dec 31	2015	2016	2017	2018E	2019E
Turnover (RMB m)	50,976	55,932	75,311	90,773	91,899
Recurring net profit (RMB m)	6,073	8,408	14,471	22,281	22,384
Net margin (%)	12	15	19	25	24
Recurring EPS (RMB)	1.15	1.59	2.73	4.20	4.22
% Change	(45)	38	72	54	0
PER (x)	36.2	27.5	15.6	10.0	9.9
PBR (x)	3.14	3.03	2.53	2.11	1.89
EV/EBITDA (x)	16.3	12.8	8.8	6.0	6.0

Sources: Company, CGIS Research

China Cement Sector

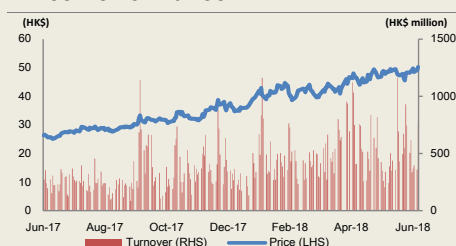
BUY

Close: HK\$50.25 (Jun 12, 2018)

Target Price (H): HK\$59.50 (+18.4%)

Target Price (A): RMB45.10 (+20.7%)

Price Performance



Source: Bloomberg

Market Cap	US\$31,642m
Shares Outstanding	5,299.3m
Auditor	KPMG
Free Float	55.0%
52W range	HK\$24.80-50.45
3M average daily T/O	US\$70.5m
Major Shareholding	Conch Holdings (36.78%)

Sources: Company, Bloomberg

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Key financials

Conch Cement (00914.HK; 600585.CH)
 Income Statement
 (RMB'000, except for per share amount)

	2015		2016		2017		2015	2016	2017	2018E	2019E
	1H	2H	1H	2H	1H	2H					
Year ended 31 Dec											
Revenue	24,223,323	26,752,713	23,973,109	31,958,792	31,907,916	43,402,904	50,976,036	55,931,901	75,310,820	90,772,638	91,898,926
COGS	(17,635,061)	(19,631,931)	(16,790,431)	(21,605,854)	(22,017,931)	(27,770,664)	(37,266,992)	(38,396,285)	(49,788,595)	(54,047,843)	(55,244,998)
Gross profit	6,588,262	7,120,782	7,182,678	10,352,938	9,889,985	15,632,240	13,709,044	17,535,616	25,522,225	36,724,795	36,653,928
Operating expenses	(2,687,472)	(3,602,073)	(2,948,751)	(3,479,325)	(2,958,059)	(4,084,222)	(6,289,545)	(6,428,076)	(7,042,281)	(7,339,140)	(7,579,211)
Operating profit	3,900,790	3,518,709	4,233,927	6,873,613	6,931,926	11,548,018	7,419,499	11,107,540	18,479,944	29,385,655	29,074,717
Other income and gains	689,651	570,883	491,397	405,389	499,042	312,545	1,260,534	896,786	811,587	1,126,325	1,137,434
EBIT	4,590,441	4,089,592	4,725,324	7,279,002	7,430,968	11,860,563	8,680,033	12,004,326	19,291,531	30,511,980	30,212,151
Net finance costs	(246,654)	(263,739)	(255,004)	(174,276)	(71,207)	31,049	(510,393)	(429,280)	(40,158)	316,110	742,725
Profits from associates and JCEs	33,428	(71,607)	(67,595)	(29,315)	(759)	120,822	(38,179)	(96,910)	120,063	161,000	161,000
Non-recurring items	1,887,285	66,774	124,031	97,162	1,868,597	34,847	1,954,059	221,193	1,903,444	-	-
Income before tax	6,264,500	3,821,020	4,526,756	7,172,573	9,227,599	12,047,281	10,085,520	11,699,329	21,274,880	30,989,090	31,115,876
Income tax expense	(1,514,374)	(926,098)	(1,063,906)	(1,638,657)	(2,147,010)	(2,653,012)	(2,440,472)	(2,702,563)	(4,800,022)	(7,584,827)	(7,603,012)
Minority interests	(35,638)	(70,710)	(104,303)	(318,595)	(341,856)	(234,313)	(106,348)	(422,898)	(576,169)	(1,123,405)	(1,128,617)
Net income	4,714,488	2,824,212	3,358,547	5,215,321	6,738,733	9,159,956	7,538,700	8,573,868	15,898,689	22,280,858	22,384,246
Recurring net income	3,299,024	2,774,132	3,265,524	5,142,450	5,337,285	9,133,821	6,073,156	8,407,973	14,471,106	22,280,858	22,384,246
EPS (RMB)	0.890	0.533	0.634	0.984	1.272	1.729	1.423	1.618	3.000	4.204	4.224
Recurring EPS (RMB)	0.623	0.523	0.616	0.970	1.007	1.724	1.146	1.587	2.731	4.204	4.224
DPS (RMB)	-	0.430	-	0.500	-	1.200	0.430	0.500	1.200	1.892	2.112
Depreciation and amortization	2,175,521	2,282,536	2,331,110	2,420,555	2,368,699	2,463,032	4,458,057	4,751,665	4,831,731	5,232,982	5,232,982
EBITDA	6,799,390	6,300,521	6,988,839	9,670,242	9,798,908	14,444,417	13,099,911	16,659,081	24,243,325	35,905,962	35,606,133
Cement and clinker ASP (Rmb/tonne)	204.5	185.1	182.1	209.0	229.8	261.5	193.8	197.9	247.1	287.6	286.0
Cement and clinker vol. ('000 tonnes)	115,360	141,225	127,680	149,394	133,596	161,341	256,585	277,074	294,937	302,471	307,259
Cost per tonne (Rmb)	146	134	126	137	154	164	139.4	132.9	159.9	168.8	169.8
Gross profit per tonne (Rmb)	59	51	56	72	75	97	54.4	65.0	87.3	118.9	116.2
Growth Rates:											
Revenue	-16%	-16%	-1%	19%	33%	36%	-16%	10%	35%	21%	1%
EBIT	-44%	-44%	3%	78%	57%	63%	-44%	38%	61%	58%	-1%
EBITDA	-33%	-31%	3%	53%	40%	49%	-32%	27%	46%	48%	-1%
Core net income	-43%	-46%	-1%	85%	63%	78%	-45%	38%	72%	54%	0%
Recurring EPS	-43%	-46%	-1%	85%	63%	78%	-45%	38%	72%	54%	0%
Margins and Ratios:											
Gross margin	27.2%	26.6%	30.0%	32.4%	31.0%	36.0%	26.9%	31.4%	33.9%	40.5%	39.9%
Net margin	13.8%	10.6%	14.1%	17.1%	17.8%	21.6%	12.1%	15.8%	20.0%	25.8%	25.6%
EBIT margin	19.0%	15.3%	19.7%	22.8%	23.3%	27.3%	17.0%	21.5%	25.6%	33.6%	32.9%
EBITDA margin	28.1%	23.6%	29.2%	30.3%	30.7%	33.3%	25.7%	29.8%	32.2%	39.6%	38.7%
Effective tax rate	24%	24%	24%	23%	29%	22%	24%	24%	25%	24%	24%

Sources: Company data, CGIS Research estimates

Figure 1: Quarterly results highlights

Y/E Dec (RMB '000)	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Turnover	11,181,618	13,041,705	13,659,068	13,093,645	10,561,949	13,411,160	13,890,129	18,068,663	13,402,628	18,505,288	17,927,022	25,475,882	18,455,318
Gross Profit	3,240,900	3,347,362	3,172,171	3,948,611	2,596,368	4,586,310	4,665,984	5,686,954	3,724,132	6,165,853	5,699,451	9,932,789	7,430,427
Margin	29.0%	25.7%	23.2%	30.2%	24.6%	34.2%	33.6%	31.5%	27.8%	33.3%	31.8%	39.0%	40.3%
Operating profit	1,974,797	1,925,993	1,789,941	1,728,768	1,210,636	3,023,291	3,056,176	3,817,437	2,252,545	4,679,381	3,942,938	7,605,080	5,938,363
Net Profit	1,713,524	3,000,964	1,397,375	1,426,837	1,155,094	2,128,798	2,613,502	2,601,819	2,153,218	4,562,698	3,091,930	6,251,912	4,778,070
Adjusted net profit	1,662,015	1,637,009	1,462,193	1,311,939	1,108,801	2,156,723	2,334,773	2,807,677	1,643,014	3,694,272	3,110,643	6,198,352	4,761,067
YoY Change	-33%	-51%	-38%	-53%	-33%	32%	60%	114%	48%	71%	33%	121%	190%
Sales volume ('000 tonne)	50,500	64,860	70,590	70,635	57,640	70,040	71,650	77,744	59,260	74,336	76,620	84,721	59,710
YoY Change	5.2%	-1.0%	8.6%	0.1%	14.1%	8.0%	1.5%	10.1%	2.8%	6.1%	6.9%	9.0%	0.8%
ASP (Rmb/tonne)	215	195	188	180	178	186	188	225	222	236	222	286	294
YoY Change	-14.0%	-18.7%	-15.1%	-23.7%	-17.3%	-4.8%	0.2%	25.4%	24.9%	27.3%	18.2%	26.7%	32.3%
Gross profit per ton	63	55	45	57	45	65	64	80	69	81	73	123	121

Sources: Company, CGIS Research

Key financials

Conch Cement (00914.HK; 600585.CH)
 Balance Sheet
 (RMB'000, except for per share amount)

As at 31 Dec	2015	2016	2017	2018E	2019E
Inventories	4,238,039	4,548,534	4,705,200	4,900,000	5,000,000
Trade receivables	422,052	654,679	1,059,713	1,200,000	1,300,000
Bills receivable	4,465,734	6,490,614	11,120,045	13,000,000	14,000,000
Others	3,015,143	2,589,961	4,710,517	5,599,551	6,099,551
Bank balances and cash	14,285,034	15,299,566	24,428,932	30,707,767	38,978,883
Total current assets	26,426,002	29,583,354	46,024,407	55,407,318	65,378,434
PPE, net	64,107,776	64,660,953	63,293,696	65,114,355	66,131,373
Prepaid lease payments	4,489,095	4,819,674	4,904,924	4,904,924	4,904,924
Others	10,758,519	10,450,140	7,919,558	8,080,558	8,241,558
Total non-current assets	79,355,390	79,930,767	76,118,178	78,099,837	79,277,855
Total assets	105,781,392	109,514,121	122,142,585	133,507,155	144,656,289
Trade payables	3,872,683	4,362,893	4,967,098	5,200,000	5,500,000
Other payables	7,506,032	7,293,525	8,423,956	9,000,000	9,500,000
Bank and other borrowings	8,445,248	4,537,632	5,620,076	3,000,000	2,000,000
Others	578,198	855,175	2,103,173	2,092,716	2,097,262
Total current liabilities	20,402,161	17,049,225	21,114,303	19,292,716	19,097,262
Bank and other borrowings	10,739,682	11,443,109	8,358,942	4,500,000	3,000,000
Others	1,095,040	1,043,955	980,046	980,046	980,046
Total non-current liabilities	11,834,722	12,487,064	9,338,988	5,480,046	3,980,046
Total liabilities	32,236,883	29,536,289	30,453,291	24,772,762	23,077,308
Shareholders' equity	70,147,570	76,308,554	89,149,949	105,071,644	117,429,504
Minority interests	3,396,939	3,669,278	2,539,345	3,662,750	4,149,477

Statement of Cash Flow

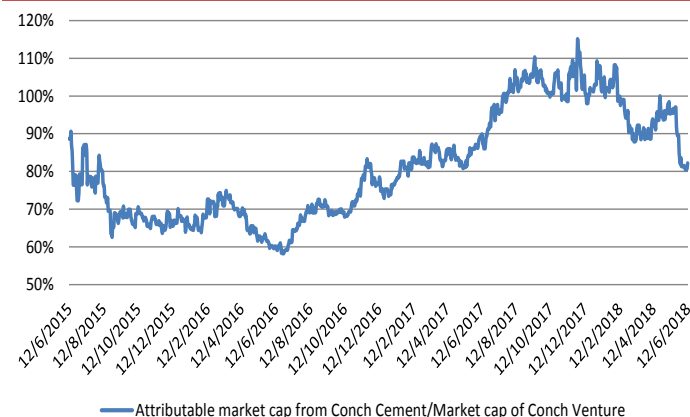
Year ended 31 Dec	2015	2016	2017	2018E	2019E
Profit before tax	10,085,520	11,899,329	21,274,880	30,989,090	31,115,876
Depreciation & Amortization	4,297,129	4,507,467	4,712,972	4,982,982	4,982,982
Change in working capital	(371,713)	(2,026,069)	(5,663,292)	(2,295,130)	(900,000)
Others / adjustments	(5,067,017)	(1,989,868)	(2,961,534)	(8,059,925)	(8,401,356)
Net operating cash flow	8,943,919	12,190,859	17,363,027	25,617,016	26,797,502
Capex	(4,210,604)	(4,581,167)	(3,656,135)	(6,500,000)	(6,000,000)
Others	(8,508,663)	28,916	(1,546,512)	-	-
Net investing cash flow	(12,719,267)	(4,552,251)	(5,202,647)	(6,500,000)	(6,000,000)
Change in debt	(733,273)	(3,204,189)	(2,001,723)	(6,479,018)	(2,500,000)
Dividends	(3,444,547)	(2,278,700)	(2,649,652)	(6,359,164)	(10,026,386)
Others	(253,249)	(662,164)	(2,848,233)	-	-
Net financing cash flow	(4,431,069)	(6,145,053)	(7,499,607)	(12,838,182)	(12,526,386)
Increase / Decrease in cash	272,913	1,014,532	9,129,366	6,278,835	8,271,116
Net cash/(debt)	(4,899,896)	(681,175)	10,449,914	23,207,767	33,978,883

Finance Ratios

	2015	2016	2017	2018E	2019E
Valuation					
PE(x)	36.2	27.5	15.6	10.0	9.9
EPS growth (%)	45	38	72	54	0
Yield (%)	1.0	1.1	2.8	4.5	5.0
PEG (x)	n.a.	0.72	0.22	0.18	21.36
EV/EBITDA (x)	16.3	12.8	8.8	6.0	6.0
PB(x)	3.14	3.03	2.53	2.11	1.89
Operational					
Revenue growth (%)	16	10	35	21	1
Gross margin (%)	26.9	31.4	33.9	40.5	39.9
Net profit margin (%)	12.1	15.8	20.0	25.8	25.6
Days receivables	33	39	47	53	59
Days payables	39	39	34	34	35
Days inventories	42	42	34	32	33
Current ratio (x)	1.3	1.7	2.2	2.9	3.4
Quick ratio (x)	0.9	1.3	1.7	2.3	2.8
Asset/Equity (x)	1.4	1.4	1.3	1.2	1.2
Net debt/equity (%)	7	1	Net cash	Net cash	Net cash
EBITDA interest coverage (x)	25.7	38.8	603.7	(113.6)	(47.9)
Core ROE (%)	8.9	11.5	17.5	22.9	20.1

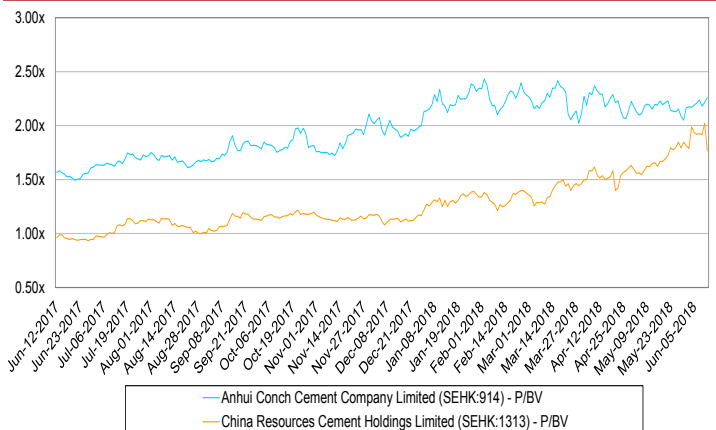
Sources: Company data, CGIS Research estimates

Figure 2: Attributable market cap from Conch Cement/Market cap of Conch Venture



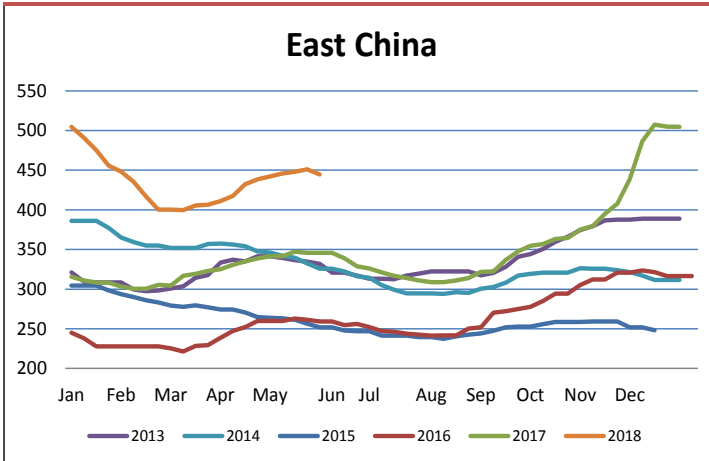
Sources: Bloomberg, CGIS Research

Figure 3: Narrowing PBR gap between Conch Cement and CR Cement



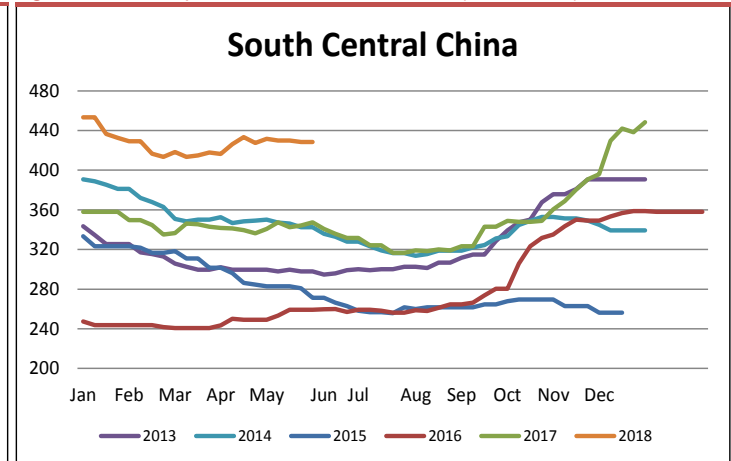
Sources: Capital IQ, CGIS Research

Figure 4: Cement prices in east China (RMB/tonne)



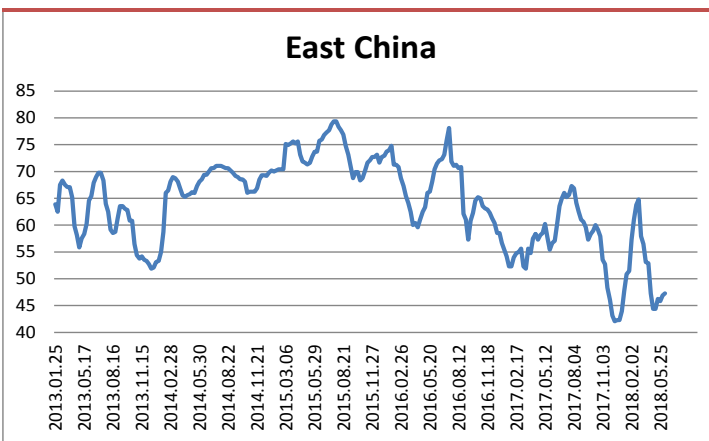
Sources: Digital Cement, CGIS Research

Figure 5: Cement prices in south central China (RMB/tonne)



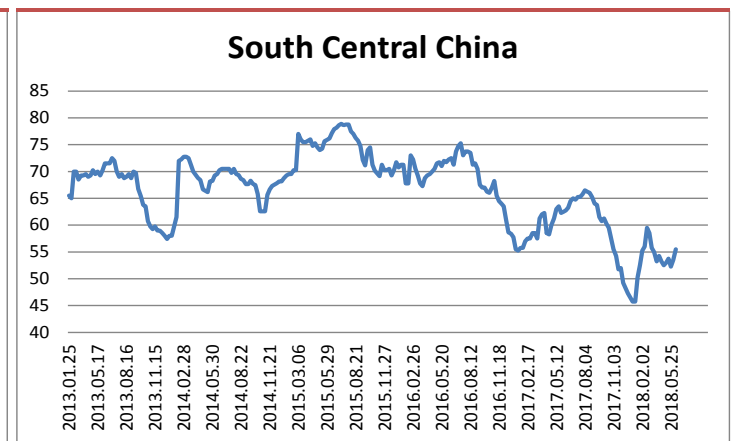
Sources: Digital Cement, CGIS Research

Figure 6: Cement inventory level in east China



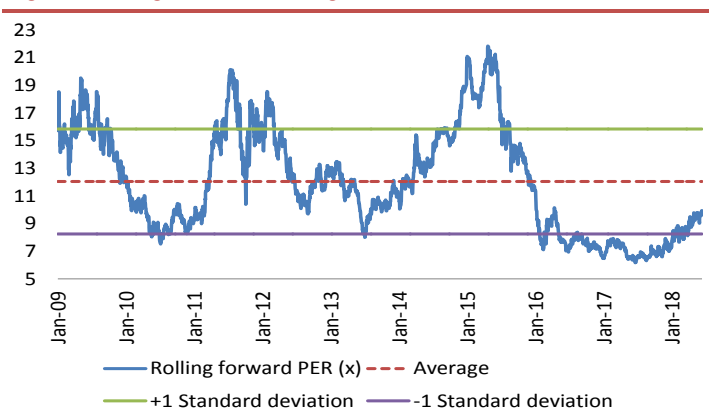
Sources: Bloomberg, CGIS Research

Figure 7: Cement inventory level in south central China



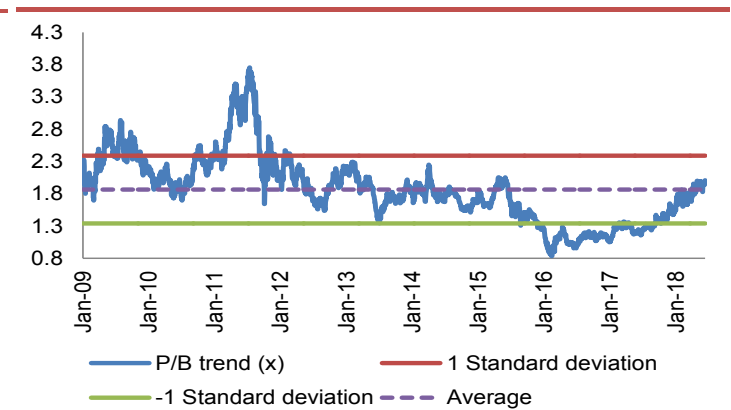
Sources: Bloomberg, CGIS Research

Figure 8: Rolling forward PER range



Sources: Bloomberg, CGIS Research

Figure 9: Rolling forward PBR range



Sources: Bloomberg, CGIS Research

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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

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