

Proxy to heating potash market

Not Rated

Key points:

- China's potash import price has tripled.
- Estimated 250,000 tonnes potash output this year.
- Plans to expand capacity to 500,000 tonnes by 2010.
- Undemanding valuation compared industry peers.
- Engaged in other businesses mainly via A-share subsidiaries.

Hong Kong Industrials

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Overview. CATIC Shenzhen is a listing holding vehicle under state-owned CATIC group. Major assets can be categorized into four segments: electronics, retail, property and fertilizer, of which fertilizer business will be the company's future focus.

Table 1: Major assets

Assets	Principal operation
Electronics	
Shenzhen Tian Ma - A (000050 CH) (51.89%)	Manufacture and sale of LCD
Shanghai Tian Ma Microelectronics (51%)	Manufacture and sale of LCD
Shenzhen Shennan Circuit Co. Ltd (95%)	Manufacture and sale of PCB
Shenzhen Maiwei Cable TV Equipments (60%)	Manufacture and sale of electronic components of cable television appliances
Shenzhen CAERO Digital Display (51%)	Development of digital displays
Retail	
Shenzhen Fiyta - A (000026 CH) (68.19%)	Retail timepieces
Property	
CATIC Real Estate - A (000043 CH) (50.14%)	Commercial property development and management
Fertilizer	
Haixi CATIC Sanjiaguuye Company (95%)	Manufacture and sale of potash

Source: Company data

Fertilizer Division

Industry update. China, each year, consumes approximately 13m tonnes potash, of which around 75.0% comes from overseas. According to the new procurement agreements between Sinofert (297 HK, HK\$5.80, NR) and major overseas vendors, potash (95.0% potassium chloride) ex-factory price in 2008 will increase from around US\$180 per tonne to US\$580, which will bring the end selling price to as much as US\$700 – 750 after including transportation and other costs from previous around US\$300 per tonne.

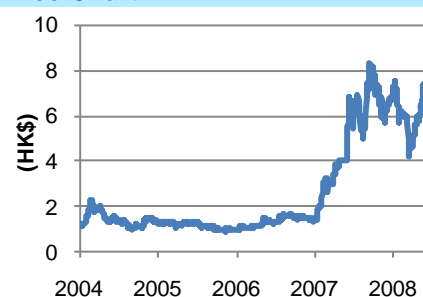
Stock data

Price	HK\$6.80
12 mth range	HK\$4.00-8.65
Market cap.	US\$597.1m
No. shares o/s	683.2m
Daily t/o, 3 mth	US\$0.7m
Free float %	39.8%
Major shareholder	CATIC – 58%
Ticker	161.HK/0161 HK

Financial summary

Year to Dec	07A
Yield (%)	1.0
ROE (%)	12.2
Net gearing (%)	81.5
Net debt/sh. (RMB)	3.570
BV/sh. (RMB)	5.42
Consensus EPS (RMB)	
- 12/08F	n.a.
- 12/09F	n.a.

Price Chart



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CATIC's potash business. CATIC Shenzhen acquired 95.0% interest in Haixi CATIC Sanjiaguiye Company (SJGY) at the middle of this year for RMB522.5m (60.0% from parent at RMB330.0m, 30.0% from Mr. Yang, an independent third party, at RMB27.5m and 5.0% from Tiantian Potash, a company wholly controlled by Mr. Yang, at RMB165.0m). The company is further negotiating with Tian Tian Potash to obtain the remaining 5.0% stake at around RMB125.0m. Hence the total consideration for the entire SJGY will be RMB647.5m.

Table 2: Transactions involved in acquiring SJGY

Date of transaction announced	% stake in SJGY	Vendor	Consideration	Status
Jan 2008	60.0%	CATIC group	RMB330.0m	Approved in May
Jan 2008	30.0%	Mr. Yang	RMB27.5m	Approved in May
Jan 2008	5.0%	Tiantian Potash	RMB165.0m	Approved in May
Jun 2008	5.0%	Tiantian Potash	RMB125.0m	In negotiation
Total	100.0%		RMB647.5m	

Source: Company data

Operation. SJGY is a potash (mainly 85.0% potassium chloride) producer located in Lenghu District, Haixi Prefecture of Qinghai province. It has about 63.0m tonnes potash reserve. Authorized output is 250,000 tonnes per annum on 400,000 tonnes designed capacity (10 production lines). Affected by the acquisition negotiation, it produced only 100,000 tonnes in 2007. Nevertheless, according to the management, production resumed in Apr 2008 and monthly output reached 30,000 tonnes in May. Looking forward, the company plans to upgrade and expand its capacity to 500,000 tonnes by 2010.

Earnings forecast. Fertilizer prices in China are closely monitored by the government. Though the new price guidance has not come out yet, we expect substantial up-adjustment to factor the import cost hike and 85.0% potassium chloride price to reach RMB4,000 (US\$570) per tonne in 2008. However the government may restore VAT tariff for potash producer. We preliminary estimate CATIC Shenzhen's turnover from potash operation will be RMB851.1m for FY12/08F. The company discloses its aggregate pre-tax cost (including direct production cost and expenses paid to sub-contractors) to be around RMB1,600 per tonne. Accordingly segmental net profit will be RMB338.3m.

Risks. Other than uncertain long-term potash price trend, we regard government policy another major risk.

Other Divisions

LCD panel plant. The company's 4.5G LCD panel production line commenced operation in Apr. However, in view of recent slow-down in global LCD TV market and continuous capacity expansion of major panel makers, we think profitability of this line might not be able to meet the company's expectation. We estimate it will break even in FY12/09F.

Expanding retail network. The company operates "HARMONY" store chain across the country, retailing high-end / luxury timepieces. It plans to spend total RMB531.6m to upgrade six old stores and open 11 new stores in 9 cities in the future.

Acquisition of CATIC Real Estate. The company acquired total 27.79% interest in CATIC Real Estate from its parent and sister company and become the largest shareholder (50.14%). CATIC Real Estate is an A-share company, engaged mainly in developing and managing commercial properties.

Corporate governance and valuation

Corporate governance. The company's substantial shareholder is China National Aero-Technology Import and Export Corporation (57.9%), which, in turn, is jointly controlled by China Aviation Industry Corporation I and II.

Valuation. All the company's businesses except fertilizer division will be operated separately by different subsidiaries. We think this corporate structure will materially impact the company's cash flow as well as valuation. For potash business, its major domestic peer, Qinghai Salt Lake, is trading at 30.7x forward P/E. Comparably, the present valuation of CATIC Shenzhen is undemanding.

Table 3: Peer comparison

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
CATIC Shenzhen	161 HK	12/2007	597.1	19.3	n.a.	n.a.	12.2
Qinghai Salt Lake	000792 CH	12/2007	9,561.5	67.6	30.7	21.8	44.1
Agrium	AGU US	12/2007	14,969.4	21.4	15.0	12.2	20.4
Potash Corp	POT US	12/2007	69,405.9	50.9	20.6	13.5	25.1
Mosaic	MOS US	05/2007	62,558.8	46.7	33.3	11.4	10.9

Source: Bloomberg

Table 4: Segmental results

Y/F 31 Dec (RMBm)	06A	07A	08F	09F	10F
Turnover	2,629.8	3,357.2	7,892.0	10,797.0	12,722.2
LCD	1,518.0	1,721.2	2,639.6	3,958.9	4,564.7
PCB	572.2	786.8	983.6	1,229.4	1,413.9
Cable television equipment	35.0	25.1	26.3	27.6	29.0
Timepieces	453.3	761.3	1,142.0	1,598.8	2,078.4
Properties	51.2	62.8	2,249.6	2,875.8	3,274.5
Fertilizer			851.1	1,106.4	1,361.7
Segmental results					
LCD	91.0	82.3	(117.0)	59.2	186.0
PCB	86.7	119.1	148.9	186.1	214.1
Cable television equipment	(6.3)	(6.1)	(6.1)	(6.1)	(6.1)
Timepieces	(7.3)	34.8	75.0	137.0	219.7
Properties	37.4	45.6	461.0	574.3	634.0
Fertilizer			451.1	586.4	961.7
Net profit	123.1	198.8	636.1	859.2	1,248.6

Source: Company data, SBI E2-Capital

Table 5: P&L

Y/F 31 Dec (RMBm)	05A	06A	07A
Revenue	1,971.5	2,629.8	3,357.2
Cost of sales	(1,523.3)	(2,024.8)	(2,582.6)
Gross profit	448.2	605.0	774.6
Other income	9.5	9.2	24.6
Distribution costs	(99.3)	(140.6)	(166.1)
Administrative expenses	(217.1)	(228.1)	(319.8)
Other gain - net	(46.0)	24.5	43.2
Operating profit	95.4	270.0	356.4
Excess of the share of the net fair value of an associate's identifiable assets, liabilities and contingent liabilities over the cost of investment			60.1
Finance costs - net	(23.8)	(58.7)	(94.1)
Share of profit / (loss) of associates	(5.5)	0.1	(7.2)
Profit before income tax	66.1	211.4	315.3
Income tax expense	(17.7)	(31.0)	(36.2)
Loss from discontinued operations	(3.7)		
Profit before MI	44.7	180.4	279.0
Minority interests	(27.8)	(57.3)	(80.2)
Net profit	17.0	123.1	198.8
EPS - basic (RMB)	0.032	0.192	0.313
EPS - diluted (RMB)	0.032	0.192	0.313
Proposed dividend	8.3	38.5	38.2

Source: Company data