SBI E2-Capital

Cement Sector

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Post results sector recap

Kennedy Tsang
(852) 2533 3713
kennedytsang@sbie2capital.com

Key points:

- Key HK-listed cement producers have all announced FY12/08A earnings
- According to NDRC, China's total cement output in 2008 was 1.4b tonnes. Estimates suggest that Chinese government's stimulus package would boost demand by upwards of 93m tonnes in 2009
- We provide summaries and latest developments for Anhui Conch (914 HK), Asia Cement (743 HK), Sinoma (1836 HK), CNBM (3323 HK) and Shanshui Cement (691 HK), TCC International (1136 HK)
- Sector has rallied since the end of 2008 as it is considered: 1) a key beneficiary of the government's stimulus package; 2) a play on the rural development theme and 3) a domestic consumption story. We think the sector as a whole is fair value at 16.0x 09F earnings (~15.0% discount to its China-listed peers)
- We advise investors to switch from Shanshui Cement to Sinoma. While the stock has an in line consensus valuation of 17.5x 09F and 13.7x 10F P/E, it is attractive on a 09F EV/EBITDA valuation of 5.7x (average 8.5x). Moreover, the company is a M&A play with gross cash of RMB14.8b and net cash of RMB2.0b

Earnings announced by key cement producers. Key HK-listed cement producers have all announced their FY12/08A results. According to NDRC, China's total cement output totaled 1.4b tonnes in 2008 (up 5.2% YoY) and estimates from various sources suggest that infrastructure projects from Chinese government would offset declining FAI and may drive overall cement demand by upwards of 93m tonnes. To provide a sector reference and outlook for our clients, we have produced a report that summarises the key developments and takeaways of the following companies: Anhui Conch (914 HK), Asia Cement (743 HK), Sinoma (1836 HK), CNBM (3323 HK) and Shanshui Cement (691 HK), TCC International (1136 HK).

Anhui Conch (914 HK, HK$47.45)

Conch announced FY12/08A results on 30 Mar 2008. Revenue was up 29.0% YoY to RMB24,228.3m and net profit up 5.1% YoY to RMB2,607.2m. For FY12/08A, Conch had sales volume of 77.1mt cement (up 20.3% YoY) and 25.9mt clinker (up 11.5% YoY) at ASP of RMB244.7/t and RMB195.7/t respectively. Export sales accounted by 11.7% of revenues.

- Management expects overall industry demand in 2009 to be up 5-6% with most of the growth expected to come in 2H. Newly added capacity in the industry in 2009 is expected to be 100mt, with around 60-65% to come in 1H. 1Q 2009 cement demand flat. Expect a growth of around 2% YoY in 2Q
- Conch is targeting total sales volume to grow ~20% YoY in FY12/09 to ~120mt (45% 1H / 55% 2H split)
- Expects sequential improvement in gross margin on a QoQ basis, with 1Q being the worse, being slow part of the season. Overall FY12/09 gross margin is expected to improve on FY12/08A's 24.4%. Management has already seen a slight increase in cement prices in April
- Due to sustained construction activity, management does not expect cement prices to fall sharply over the next two years. Meanwhile, they are expecting production costs to top out at around RMB160/t. Coal prices are expected to fall around RMB100 from average 2008 prices as two of the four key industries for use of coal (mining and chemical) are expected to see slow down
- Management expects cement demand in Sichuan to drop off significantly after the peak of reconstruction activity. However, Conch is well positioned in this regard as most of their cement production capacity is located in the eastern side of Sichuan rather than near Chengdu, so it can benefit from rural infrastructure build out
- 2009 capex budget is RMB8.0b. After all construction-in-progress are completed, clinker and cement production capacities will reach 108.5mt and 119.9mt respectively

Asia Cement (743 HK, HK$6.40)

AC announced FY12/08A results announced on 14 Apr 2008, with revenue up 44.0% YoY to RMB3,248.2m and net profit up 67% YoY to RMB410.2m. Sales from Central Yangtze Delta and Sichuan accounted for 50.0% and 35.0% of sales respectively. Sales in Sichuan was up 77.0% YoY. Company had cement sales volume of 9.9mt at an ASP of RMB286/t.

- Cement prices in AC's key areas remain firm. Chengdu cement prices are ~RMB450/t (ex. VAT), Nanchang around RMB240/t and Wuhan ~RMB260/t. Company is targeting sales volume of ~14mt in FY12/09
- 1Q FY12/09 sales volume around 2.4mt, up 41.2% YoY. Increase is mainly due to lower base from snowstorms in 1Q FY12/08 and increased production capacity from Sichuan Line 2, which came on line in Oct 2008
- 1Q FY12/09 average coal prices were around RMB700/t (FY12/08A average: RMB750/t). Management indicated that this was still on the high side as they were still in the process of consuming inventory-on-hand. Coal prices for new contracts signed were between RMB600-650/t
- 1Q FY12/09 gross margin was around 29% (FY12/08A: 28.0%) and management expects gross margins in 2Q to improve as they begin to consume coal from new lower priced contracts. Gross margin in Sichuan was 51.0% in FY12/08A
- Company has secured supply contracts for several large government infrastructure projects, including: Hanyi Expressway (Wuhan Section) and Shiwu Expressway (Hubei Section)
- In terms of competition landscape, management does not expect any new production capacity within 100km of Chengdu in 2009. For AC, Sichuan Line 3 will be on line by 1Q 2010. Expansion by other key competitors are expected to come on line between 1H to end-2010. Overall cement demand in Sichuan is projected to reach 20mt in 2010 and AC, with 6mt production capacity, will account for 30.0%. Other key competitors in Sichuan include LaFarge (4mt by end-2010) and Conch (4mt)
- AC has a net gearing ratio of 26.0%, low for the industry. By end-FY12/10, AC targets to have 13.86mt production capacity (end-FY12/08A: 6.93mt)

Sinoma (1893 HK, HK$5.98)

Revenue increased 21.8% YoY to RMB25,244.8m, net profit up 16.0% to RMB564.6m. Gross margin widened 1.7 pcp YoY to 18.1% and net profit narrowed 0.1 pcp YoY to 2.2%. The margin squeeze was mainly affected by the forex loss (from RMB13.8m in 2007 to RMB238.2m in 2008), other expenses mainly related to project compensation (from RMB29.9m in 2007 to RMB277.2m in 2008) and minority interests (from RMB678.5m to RMB955.8m).

- Cement segment revenues was up 30.0% YoY to RMB6,250.6m. It accounted for 24.8% of revenues, but 45.3% of operating profit
- Cement sales volume to 49.1% YoY to 17.6mt and clinker sales volume up 21.7% YoY to 2.6mt
- 2009 budgeted capex is RMB6.5b. Around RMB3.6b, or 55.9% is earmarked for the cement segment. Specific activities, include expansion of cement production lines, investment into residual heat electricity generation and construction of carbon slag based clinker line
- Management indicated that cement prices in Guangdong and Jiangsu have begun to stabilize after prices fell towards the end of 2008
- Demand from Northwest China continues to rise and this is will be a key growth region for the company. It currently has production capacity of 18.0mt in this region and another 14.4mt is currently under planning/construction
- Sinoma in FY21/09F is expecting to have production capacity of 42m tonnes by organic growth (over 50m tonnes including M&A). Management is targeting sales volume of over 27m tonnes (excl. the M&A) to achieve net profit growth of 50%+ YoY in this segment

Shanshui Cement (691 HK, HK$4.02)

Posted FY12/08A results on 20 Apr 2008. Company's revenues was up 81.0% YoY to RMB7,500.8m, gross profit was up 105.6% YoY to RMB1,586.4m while net profit came in at RMB549.2m, up 155.9% YoY. Gross margin improved 2.6pcp to 21.2%. Total cement and clinker sales volume reached 25.1mt in FY12/08A, up 45.7% YoY with cement ASPs in Shandong at RMB233.0/t and Liaoning at RMB249.5/t.

- Management explained that the strong ASP growth in Shandong in 2008 (up 27.2% YoY) was due to a combination of strong economic growth, Shandong government aggressively shutting down old capacities. Shandong traditionally had one of the lowest cement ASPs in China due to over capacity
- Strong revenue growth was due to increasing volume as well as ASPs, including maiden contribution from Liaoning. Shanshui acquired two firms in Liaoning in 2008 and now has the largest market share in the province. Organic growth was 36.0% and acquisition growth was up 81.0% YoY
- Demand and pricing in 1Q FY12/09 has remained firm. Cement prices during this traditionally weak season has

remained around RMB235/t (in Shandong) and management has indicated that sales volume has increased around 10% YoY thus far

- Cement prices in Shandong for the year are likely to be sustained with bidding prices for government projects generally slightly higher than market prices. Moreover, may of these government projects have specified that use of old capacities would be prohibited, further aiding Shanshui's cause. Management has guided stable ASPs and slight growth in margin in 2009
- Local government stimulus budgets for 2009 are RMB1.6b for Shandong and RMB1.3b for Liaoning
- Company's peak investment year has passed. Capex budget for FY12/09 is RMB569.0m (FY12/08A: RMB2,439.0m). This would aid managements' aim to continue to lower net gearing ratio (FY12/08A: 43.6%)

TCC International (1136 HK, HK$2.91)

TCC announced its FY12/08A results on 23 Mar 2008. Revenue up 55% YoY to HK$2,282.8m and net loss of HK$115.5m (FY12/07A: HK$3,473.4m loss including a HK$3,722.6m impairment loss). A surge in admin expenses (up 58.8% YoY to HK$145.4m) and finance costs, which totaled HK$129.4m in FY12/08A continue to drag down TCC's earnings. At end-FY12/08A, the company had a net debt position of HK$2,516.5m and a net gearing ratio of 64.7%. For the year, the TCC had cement sales volume of 9.7mt.

- Company should see solid margin expansion in 2009 on a combination of: 1) lower coal price and 2) gradual transition to residual heat power generation. TCC is aiming to achieve average production costs of between RMB160-200/t
- Expect 1H FY12/09 volumes to increase on YoY basis. This is due to combination of additional capacity and coming off a low base in 1H FY12/08 from snowstorms and earthquake. Management has seen a small pick up in demand since Dec 2008
- The company has solid capacity expansion plans but our main concern with the company is that it operates in the highly competitive Southern and Eastern China area. These regions have also borne the brunt of the property slowdown
- Capex budget for FY12/09 and FY12/10 is around RMB1,000m each year
- A positive for the company is that its Taiwan-based parent company is solely focused on the cement sector. TCC Int'l holds the majority of the company's China assets. As Taiwan is a mature market, its parent company will be motivated to support TCC Int'l's operations and expansions in China

CNBM (3323 HK, HK$15.00)

FY12/08A results for the diversified construction materials producer were announced on 21 Apr 2008. Revenue surged 150.8% YoY to RMB26,365.2m while net profit came in at RMB1,511.5m, up 65.7% YoY. CNBM's cement segment revenues jumped 286.0% YoY to RMB18,349.6m on a combination of additional capacity and consolidation of increased equity interest in subsidiaries. The segment accounted for 69.6% of revenues and 68.6% of operating profit. Company had a net gearing ratio of 177.0% at end-FY12/08A

- South China (SC) had sales volume of cement 33.0mt and clinker14.0mt (FY12/07A: 3.0mt and 2.0mt). ASPs were cement RMB233/t and clinker RMB222/t respectively
- China United (CU) had sales volume of cement 23.0mt and clinker9.0mt (up 64.3% YoY and 28.6% YoY). ASPs were cement RMB232/t and clinker RMB211/t respectively
- Management indicated while cement prices fell in the last two months of 2008, it had now stabilized and is gradually moving up. On a YoY basis for 1Q FY12/09, CU's cement ASP is up 13% and SC cement ASP is up 3.0%. Meanwhile, coal prices have come down to around RMB600/t (from >RMB700/t for CU and >RMB800/t for SC in FY12/08A)
- In FY12/09, company will focus on: 1) improving profitability through cost measures such as build out of residual heat electricity generation; 2) integration/restructuring of operations; 3) establish core profit regions

Our view. The cement sector as a whole has rallied since the end of 2008 as it is considered: 1) a key beneficiary of the government's stimulus package; 2) a play on the rural development theme and 3) a domestic consumption story. We think the sector as a whole is fair value at 16.0x 09F earnings (~15.0% discount to its China-listed peers). We had previously recommended Shanshui Cement for its: 1) undemanding valuation and 2) leading market position in Shandong and Liaoning. The stock has rallied 30.1% since announcing its results on 20 Apr and is currently trading at 12.3x FY12/09F P/E based on our estimates. We advise investors to switch from Shanshui Cement to Sinoma. While the stock has an in line consensus valuation of 17.5x 09F and 13.7x 10F

P/E, it is attractive on a 09F EV/EBITDA valuation of 5.7x (average 8.5x). Moreover, it is a net cash company, with gross cash of RMB14.8b and net cash of RMB2.0b. Given that its other SOE peer CNBM has a net gearing ratio of close to 177.0%, we think that going forward, Sinoma will be presented with more M&A opportunities. Moreover, Sinoma's cement production is concentrated in the north and northwest China, where it is aligned with the government's policies to develop inland areas. Risk for Sinoma is its exposure to cement equipment and engineering services.

Table 1: Valuation table

Company name	Ticker	Mkt cap (US$m)	Last Price (Local)	Cur Est P/E (x)	Nxt Est P/E (x)	Cur EV/EBITDA (x)	Est ROE (x)	Net Grg (%)
HK-listed								
Anhui Conch	914 HK	9,976.9	HK$47.45	22.1	17.4	11.0	12.9	16.4
CNBM	3323 HK	4,802.4	HK$15.00	15.9	12.5	11.8	18.0	177.0
Sinoma	1893 HK	2,755.8	HK$5.98	17.5	13.7	5.7	13.5	20.7
China Shanshui	691 HK	1,401.0	HK$4.02	12.3	9.1	7.2	16.0	43.6
Asia Cement	743 HK	1,285.2	HK$6.40	12.3	11.0	6.7	11.5	26.0
TCC Int'l	1136 HK	481.7	HK$2.91	n/a	n/a	n/a	n/a	64.7
Average				*16.0*	*12.7*	*8.5*	*14.4*	*58.0*
China-listed								
Tangshan Jidong	000401 CH	2,649.5	RMB14.92	24.2	16.8	14.5	11.0	49.9
Xinjiang Tianshan	000877 CH	610.9	RMB13.37	15.4	12.7	8.7	27.2	178.6
Ningxia Saima	600449 CH	775.7	RMB27.15	16.7	13.0	10.7	17.5	Cash
Jilin Yatai	600881 CH	1,986.4	RMB10.74	16.0	19.3	n/a	6.7	98.7
Huaxin Cement	600801 CH	1,157.1	RMB23.83	17.0	13.5	7.2	11.2	64.0
Jiangxi Wannianqing	000789 CH	478.3	RMB8.25	22.0	16.7	19.8	13.4	67.5
Average				*18.6*	*15.3*	*12.2*	*14.5*	*91.7*

Source: Bloomberg

Table 2: 52 week high/low

(%)	914 HK	1893 HK	3323 HK	691 HK	743 HK	1136 HK
52 week high	HK$76.50	HK$8.92	HK$22.00	HK$4.22	HK$8.00	HK$7.70
52 week low	HK$13.50	HK$1.48	HK$1.46	HK$0.76	HK$1.34	HK$0.65

Source: Bloomberg, SBI E2-Capital