JCAP

Commodities
**China**

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# Anhui Conch Cement (0914 HKG)
# Easy Come, Easy Go

- **Following a decline** in Anhui Conch's share price, we are closing coverage. We reiterate our SELL rating with a target price of HKD 14.61.

Conch's share price has declined more than 40% in the last 12 months, in line with a substantial weakening of the cement market in China over the period. After bottoming out and hitting our target price in February, the share price has rebounded slightly. We believe that the overwhelming forces on Conch will be to the downside going forward, as structural weaknesses in the cement market outweigh Conch's market share advantages.

Cement prices were down 15% YoY in the first half of 2016, despite positive news around price increases during the peak spring building season. Output also continues to trend down, by about -4% YTD YoY. Producers continue to report infrastructure demand increases, but that growth makes up only a small portion of the accelerating decline from property developers. With no market upturn on the horizon, Conch will be left dealing with a market contracting faster than the company can accumulate and consolidate share. This has been demonstrated by Conch's declining ROI and profits cut by nearly half.

Conch and cement industry bulls continue to posit two main upsides for the industry in 2016, neither of which has been borne out in H1: infrastructure demand and exports. While we saw increases in infrastructure demand in H1 2016, the fundamental weakness in commercial property means gross demand has continued to decline across the board, as has been the case for two years. Overcapacity prevents prices from rising in any consistent fashion.

The next posited upside is exports. At a tiny fraction of total Chinese cement production (<1%), exports don't typically play a significant role. While Conch derives a higher proportion of revenue from this

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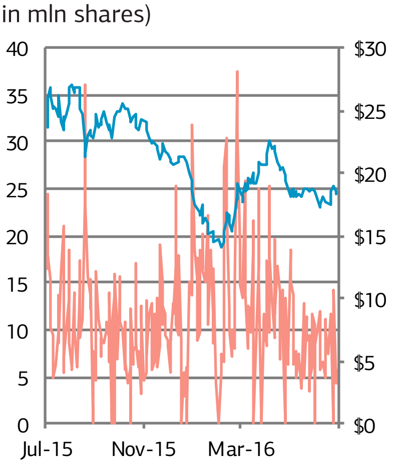
|---|---|
| Price | HKD 18.68 |
| **Rating** | **SELL** |
| **Price Target** | **HKD 14.61** |
| Difference | 21.8% |
| Market Cap | HKD 98.9 bln |
| Avg. Volume | 11.25 mln |

Anhui Conch (0914 HKG) last share price in HKD (blue) and volume (pink, in mln shares)




Source: Bloomberg

Everything in the cement industry comes back to overcapacity.

segment (3.8% in 2015), company promises of increased exports to boost declining domestic sales are simply fanciful. Exports rose 27% in 2015 for Conch, but the RMB 400 mln increase from that segment could not possibly offset the RMB 9 bln decline in revenue from other segments. In 2016, the situation has worsened: in some of the largest cement markets that provide the bulk of China's cement exports falling export demand has had its first tangible effect on price, pushing it downward. The contracting demand from this segment caused prices to fall in some locales in Jiangsu and Zhejiang in June.

These conditions set up the company for a second half that will underperform H2 2015, which was one of Conch's worst-performing periods Everything in the cement industry comes back to overcapacity: when demand increases, capacity comes back online, and prices typically stabilize. When demand falls, capacity rarely goes offline fast enough, and prices fall further. There is simply too much capacity to sustain real price growth or stabilization in China, and all the temporary demand sources are just that: temporary. We cannot find a structural reason for cement prices to rise over the next two years. This means contracting margins amid falling revenues, which translate into declining cash flows for a company dependent for its valuation on being cash generative.

The reality for Conch is that it is running out of cash: cash from operations halved in 2015 YoY, while investment skyrocketed to be on par with the cash generated, leaving us concerned about the quality of the cash they do have on hand, which is down almost 70% over the last year.

We close coverage reiterating our SELL recommendation with a target price of HKD 14.61.

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# Disclaimer



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