



Flash Note: Cement and Construction Materials Sector

快讯：水泥建材行业

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7 June 2017

The 13th Five-Year Plan for the Domestic Cement Industry

水泥行业“十三五”发展规划

- **China Cement Association has announced the 13th Five-Year Plan for the domestic cement industry**, which articulates clear targets for industry capacity governance over the 13th Five-Year period. Our core views regarding this plan are as follows:
- **Capacity elimination target strengthened.** A 400 million ton clinker capacity cut has proposed in the plan, representing approximately 20% of domestic total clinker capacity. This amount can be translated to a potential cut of 700 million tons of cement volume under the current clinker-cement multiplier. Based on this plan, clinker capacity utilization rate would no doubt be raised to above the 80% level, even without considering any other capacity or production control measure. If the P.C.32.5 cement elimination is executed by that time, we estimate clinker capacity utilization rate to increase further to above 90%. Observations are that in a bid to achieve this capacity elimination target, capacities with scale that are smaller than 2,500t/d will likely to be wiped out. While CNBM and SINOMA owns the most, <2,500t/d lines in China, it draws our concerns if the capacity elimination scheme is strictly implemented during 2017 to 2020 and whether an enormous amount of impairment gain/loss on disposal of fixed assets will be incurred for these two names, as they have not seemed to follow their peers (e.g. Anhui Conch and CRC) in making provisions of impairment losses for their backward production lines over the past few years. Such losses will finally catch up to them.
- **Raising the domestic top 10 players' market concentration level to above 80%.** The plan articulates a 25% cut in the number of cement enterprises by the end of the 13th Five-Year plan period and targeting to raise the market concentration level of the top ten players to above 80%. This implies a more than 25 ppt leap in concentration level during 2016 to 2020, seemingly aggressive but also implies that there might be plenty of M&As within the sector from 2017 onwards. This seems exciting for Conch given its M&A plans and enormous amount of cash as a backdrop, but we are a slightly conservative on the economic benefits if Conch engages in M&A activities in the near term, as considerations might be very expensive under the current industry profitability environment to acquire some just “so so” assets, and it will also take time for Conch to adopt its management philosophy within these newly acquired lines.
- **Investment suggestion:** Anhui Conch (00914 HK) will enjoy the most benefits from the plan, given: 1) No concerns regarding the potential losses/provision from capacity being wiped out as Conch has made loss provisions for most of their backward lines over the past five years; it does not have too many lines with a scale that is under 2,500t/d now. 2) The strongest growth upside potential among all players in China through engaging in M&As and given its financial condition. 3) Resilient stock price will come about if cement demand largely misses during 2017 to 2020, with substantial earnings retracement given its cost leadership as a backdrop, but this also offers a great time for Conch's M&A ambition. 4) Higher chances for Conch's management raising the dividend payout this time, as its cash flow should be solid so far with very likely higher-than-expected 2017 earnings.
- **中国水泥协会发布了水泥工业的“十三五”发展规划**，明确的指出了“十三五”期间的水泥行业的产能治理目标。我们针对该规划的核心观点如下：
- **强化产能清出目标。**规划提出要削减4亿吨的熟料产能，相当于当前全国水泥熟料总产能的约20%。基于目前的熟料-水泥转化系数，该数量也相当于潜在的约7亿吨的水泥产量的削减。基于该规划，熟料产能利用率无疑将被提高到高于80%的水平，即便在不考虑其他任何的产能控制举措的情况下。若届时复合32.5标号的水泥清出得到执行，我们预计熟料产能利用率将进一步的提高到超过90%的水平。这表明要达到该产能清出的目标，规模小于2,500吨/天的产线都将很可能被清出。在中国建材和中材在中国拥有最多的小于2,500吨/天的生产线的情况下，我们担忧若产能清出计划在2017年至2020年间得到严格执行，对这两家公司而言是否会录得巨大的固定资产的减值损失/处置损失，源于他们并没有效仿同行(如海螺水泥和华润水泥)在过去几年间对他们的落后产线进行减值拨备，而该损失终将被录得。

- **提高全国前十企业的集中度至超过 80%。**规划指出在“十三五”的末期水泥企业的数量将削减 25%并且目标将前 10 大企业提高市场集中度至超过 80%的水平。这表明在 2016 至 2020 年之间市场集中度将提高超过 25 个百分点，看似比较激进但也表明从 2017 年往后可能有大量的并购重组在业内发生。虽然这看似对海螺水泥而言非常的令人兴奋，源于它的并购战略和大量的现金作为支柱，但是我们也对若海螺水泥在近期进行并购活动的经济收益持一些保守的看法，因为在目前的行业利润环境下，对一些质量“看似一般”的资产的收购的代价将可能非常昂贵，并且海螺水泥也将花费时间去将他们的管理理念运用于这些新收购的生产线。
- **投资建议：**安徽海螺水泥(00914 HK)将在该规划中受益最大，源于：1)没有对产能淘汰阶段的潜在的损失/拨备的担忧，因为海螺水泥已经在过去 5 年间对这些潜在的损失进行了拨备计提，并且其目前并未拥有太多小于 2,500 吨/天的生产线。2)基于其财务状况，若开始进行并购活动，海螺水泥在中国拥有最确定的增长空间。3) 若水泥需求在 2017 至 2020 年之间大幅低于预期并且盈利显著回撤，基于其成本优势海螺水泥的股价将最具防御性，并且与此同时也是海螺水泥进行并购战略的最好时机。4) 海螺水泥管理层提高派息的概率增大，因为截止目前其现金流状况应该比较坚实并且 2017 年的盈利状况也非常可能超过市场预期。

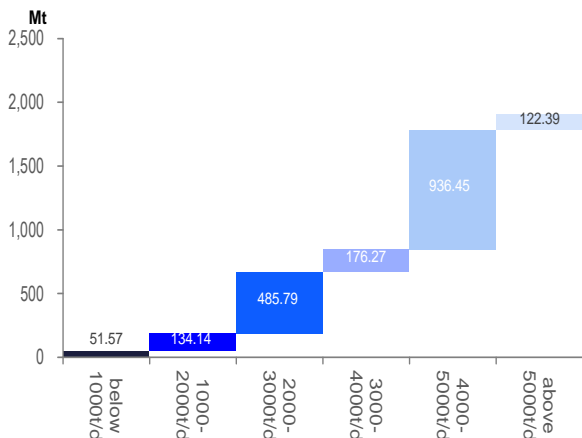
Exhibit 1: Clinker Capacity Utilization Test

Mn tons	2016	2020
Nominal clinker capacity	1832	1484
Estimated actual clinker capacity	2107	1707
Cement demand	2403	2400*
Implied clinker demand	1373	1371
Clinker capacity utilization rate	65%	80%
Implied clinker demand if P.C.32.5 cement is wiped out	n.a.	1600
Implied clinker capacity utilization if P.C.32.5 cement is wiped out	n.a.	94%

Source: Guotai Junan International.

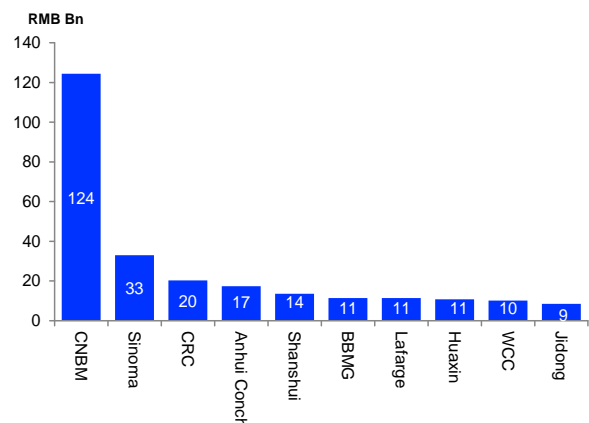
*: Assuming demand remain stable during 2017 to 2020.

Exhibit 2: Clinker Capacity Distribution in China



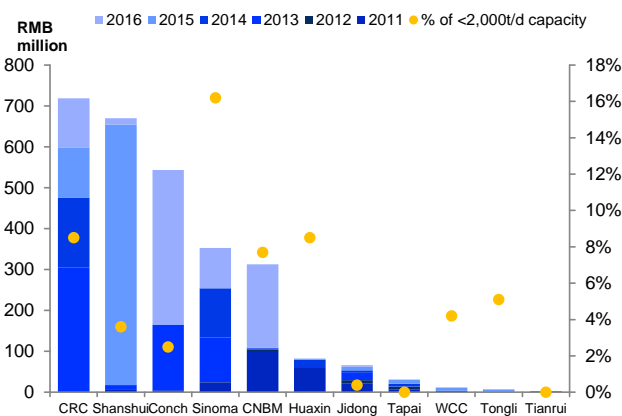
Source: Digital Cement, Guotai Junan International.

Exhibit 3: <2,500t/d Capacity Rank by Enterprise



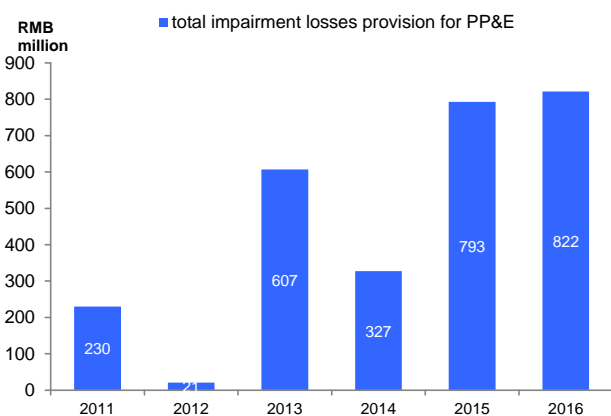
Source: Digital Cement, Guotai Junan International.

Exhibit 4: Impairment Loss Provisions for PP&E from Domestic Leading Cement Suppliers



Source: Company data, Guotai Junan International.

Exhibit 5: Total Impairment Loss Provision for PP&E from Domestic Leading Cement Suppliers



Source: Company data, Guotai Junan International.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Buy	Relative Performance >15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating	Definition
Outperform	Relative Performance >5%; or the fundamental outlook of the sector is favorable.
Neutral	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	Relative Performance <-5%; or the fundamental outlook of the sector is unfavorable.

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