

Analyst: Paul Sham

Main Board Listing – Research

中國山水水泥集團有限公司

China Shanshui Cement Group Limited [Stock Code: 00691]
Joint Global Coordinators and Joint Bookrunners

: Morgan Stanley Asia Limited
: Credit Suisse (Hong Kong) Limited

Joint Lead Managers and Joint Sponsors

Morgan Stanley Asia Limited
: Credit Suisse (Hong Kong) Limited
CCB International Capital Limited

Sector : Materials

Business : Manufacturing & sales of cement products

Total share offer: <u>*650,840,000</u> shares (25.0% of the enlarged share capital) Public Offer: 65,084,000 shares (10%) Placing: 585,756,000 shares (90%) Greenshoe: 97,626,000 shares <i>*All 650,840,000 shares are New Shares</i>	<u>Business of Shanshui Cement</u> Shanshui Cement is the 2 nd largest producer of clinker and cement in China and the largest in Shandong Province, in terms of both production and sales volumes in 2007. Shanshui Cement currently has 14 clinker production lines and 53 cement grinding lines located in Shandong Province, and 8 clinker production lines and 24 cement grinding lines located in Liaoning Province. Its products are also primarily sold to customers in these two provinces. Its domestic sales accounted for approximately 87.3%, 84.9% and 90.6% of the total revenue, respectively, in the years ended 31 st December, 2005, 2006 and 2007. The Company also sells the cement and clinker products to overseas customers, including those in the United States, Spain and the United Arab Emirates. In 2005, 2006 and 2007, the Company produced 11.0m, 14.9m and 17.3m tons of cement, and 10.7m, 12.3m and 13.9m tons of clinker, respectively. Its revenue increased from RMB2,800.4m in 2005 to RMB3,500.9m and to RMB4,144.6m in 2007, representing a CAGR of 21.7% from 2005 to 2007.
Price: HK\$2.70 – HK\$3.65 per share Market Cap: HK\$7,029 million – HK\$9,502 million Unaudited pro forma fully diluted FY08E PER: 14.2x – 19.3x Adjusted NTA per share: RMB\$1.21 – RMB\$1.42 or HK\$1.37– HK\$1.61 Staffing: 8,276 (as of 31 st December 2007)	
HK Public Offer period: 20 th June 2008 – 25 th June 2008 Receiving banks: Bank of China (Hong Kong) Limited Hang Seng Bank Limited Share registrar: Computershare Hong Kong Investor Services Ltd Listing date: 4 th July 2008	

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Shareholding Structure after Listing (Assuming the over-allotment option is not exercised)

China Shanshui Investment – 65.55% held by Zhang Caikui, the Chairman, Executive Director and General Manager; 16.19% held by Li Yanmin, the Executive Director and Deputy General Manager; 18.26% held by other 7 management shareholders.	33.49%
CDH Cement & CDH Construct – ultimately owned by CDH China Fund, L.P, which focuses on private equity investments in China.	7.57%
International Finance Corporation – an inter-governmental organization affiliated with the World Bank	3.95%
MS I, II, IV – the private equity arms of Morgan Stanley	25.23%
CCBI Cement – ultimately wholly owned by China Construction Bank Corporation	4.76%
Public Investors	25.00%
	100.00%

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,891.8 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$3.175 each, being the midpoint of the indicative price range)

	HK\$ million
For the construction of new clinker production lines, cement grinding lines, concrete mixing stations and residual heat recovery generators in Shandong and Liaoning Provinces	1,483.1
For repaying the existing loans	219.5
For additional working capital, strategic investment and other general corporate purpose	189.2

Financial Highlights

	Year ended 31 st December		
	2005 <u>RMB'000</u>	2006 <u>RMB'000</u>	2007 <u>RMB'000</u>
Revenue	2,800,352	3,500,914	4,144,552
Gross profit	485,246	625,111	771,681
Operating profit	261,937	390,177	431,907
Attributable profit	103,369	201,616	211,948
Gross margin	17.3%	17.9%	18.6%
Operating margin	9.4%	11.1%	10.4%
Net margin	3.7%	5.8%	5.1%

Revenue Breakdown by product (% of Total Revenues)

	Year ended 31 st December					
	2005 <u>RMB'000</u>	%	2006 <u>RMB'000</u>	%	2007 <u>RMB'000</u>	%
Sales of cement	1,999,707	71.4	2,815,825	80.4	3,158,341	76.2
Sales of clinker	680,086	24.3	553,286	15.8	749,948	18.1
Sales of other products & services	120,559	4.3	131,803	3.8	236,263	5.7
Total	2,800,352	100.0	3,500,914	100.0	4,144,552	100.0

Strengths/Opportunities

- ✓ **Benefit from strong fixed asset investment (FAI)** During 2002 to 2006, the FAI growth rate of Shandong Province and Liaoning Province increased at a CAGR of 33.6% and 37.2% respectively, higher than the overall growth rate of 26.1% for China. According to the 11th Five-year Plans, the FAI growth rates from 2006 to 2010 in Shandong Province and Liaoning Province are projected to be 18% and 20%, which could continue boost the sales of cement, favoring the business operations of Shanshui Cement that holds a leading market position in these two provinces.
- ✓ **Undemanding valuation** Based on the mid point of the indicative offering price, the expected P/E multiple of Shanshui Cement in FY2008E is 16.75x. Compared with the HK listed rival, Anhui Conch (00914), with PE ratio of 20.6x, valuation of Shanshui Cement looks undemanding.

Weaknesses/Threats

- × **Exaggerating title of being the 2nd largest producer** Compared with the largest clinker and cement producer Anhui Conch with annual cement production volume of 111.5m tons, Shanshui Cement's annual production volume of 27.5m appears as a much smaller player. Despite Shanshui Cement claims itself as the 2nd largest producer, its production capacity cannot be comparable to the leading player, Anhui Conch.
- × **Failed to capture the opportunity in western regions** Production & sales of cement is a regionalized business and majority of Shanshui Cement's products are sold to customers in Shandong Province and Liaoning Province. However, it is expected the supply will be much tighter in western area because of rising cement demand for reconstruction during the earthquake and the "Go-West" policy. Cement producers along Yantze River can supply Sichuan when Sichuan people start rebuilding works, enjoying the most favourable geographic location. Nevertheless, Shanshui Cement might not be able to catch the opportunity due to its limited exposure in the western provinces.
- × **Rising material cost** The costs of limestone (raw material of cement and clinker) and coal account for a substantial portion of the production costs. For the three years ended 31st December 2007, the aggregate costs of limestone & coal represented 60.6%, 60.6% and 62.0%, of the total cost of sales, respectively. Despite the PRC government imposed temporary price ceilings on coal, the continually rising limestone price would increase the pressure on cement players' gross margin.
- × **Uncertainty of the electricity cost** A week ago, Shandong province imposed measures to encourage industrial power users to shift usage to non-peak hours, by applying a trough-period discount, to 60% from 50% and a peak-consumption premium of 70%. Electricity cost constituted 23.6%, 23.9% and 21.6% of Shanshui Cement's total cost of sales for the years ended 31st December, 2005, 2006 and 2007 respectively. Therefore, the aforesaid policy might create uncertainty to the Company's cost of sales.

Recommendation: Neutral



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