

Yangzijiang (YZJSGD SP)

Industrial - Shipbuilding

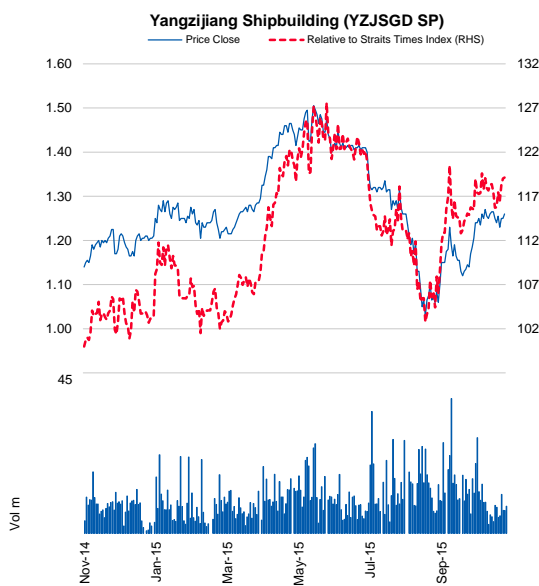
Market Cap: USD3,450m

Buy (Maintained)

 Target Price: **SGD1.61**

 Price: **SGD1.26**

In a Stronger Position To Face Tough Times

 Macro
 Risks
 Growth
 Value


Source: Bloomberg

Avg Turnover (SGD/USD)	14.4m/10.3m
Cons. Upside (%)	9.5
Upside (%)	27.8
52-wk Price low/high (SGD)	1.03 - 1.51
Free float (%)	64
Share outstanding (m)	3,832
Shareholders (%)	
Ren Yuanlin	26.0
Lido Point Investments	10.3
Hong Kong Hengyuan Investments	8.7

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	4.6	10.5	(0.8)	(14.0)	12.0
Relative	15.5	3.1	5.3	0.0	20.9

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Yangzijiang's (YZJ) 3Q15 PATMI missed, marred by mostly non-cash accounting losses. Maintain BUY with a SOP-derived TP of SGD1.61 (from SGD1.68, 28% upside). The company also announced USD730m of new orders, which included two VLGCs amid 10 containership orders, bringing the orderbook to a 5-quarter high of USD4.8bn. We continue to like Yangzijiang for its industry leadership position in technology, low cost structure and undemanding valuations.

- ◆ **Large subsidy offset by high quanta of accounting losses.** This quarter, YZJ recorded CNY557m of subsidies related to yard relocation compensation from the Government. These were offset by CNY207m losses from the disposal of A-shares (but actually sold at cost as profits were recorded in 2Q15), c.CNY150m losses from currency hedges, c.CNY130m losses from translating USD-denominated debt and a CNY100m loss from the disposal of Hengyuan Real Estate. Revenue was 28% lower QoQ due to normal fluctuations in S-curve recognition.
- ◆ **Currency losses to be recovered via higher margins.** The forex-related losses in 3Q15 were all derived from USD debt and currency hedges targeted at reducing long-term currency exposure. As a result of the USD strengthening against the CNY, the shipbuilding margin expanded to 18.5% from 14.8% in 2Q15. At the core level, earnings have not changed much on a QoQ basis.
- ◆ **Stronger position to face tough times.** YZJ's net gearing has fallen to 0.02x as of 3Q15, and its orderbook is back to a 5-quarter high of USD4.8bn. Clouding the horizon is an Asian and European slowdown, according to chairman Mr Ren Yuanlin, which is negative for shipbuilding orders. YZJ continues to target large containership orders and natural-gas vessels like the very large gas carriers (VLGCs) secured this quarter, each for USD75m. In our *Chairman Renditions* section on page 4, we further detail YZJ's strategy on M&As, public-private investments which will replace the held-to-maturity assets, etc. Our TP is slightly lowered to SGD1.61 (from SGD1.68) as we trim earnings forecasts by 7%/5%/13% for FY15-17F, and lower the shipbuilding multiple to 6x from 7x in our SOP. Nonetheless, we continue to like YZJ for being the industry leader in technology and its c.1x P/BV and 3x EV/EBITDA.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover (CNYm)	14,339	15,354	18,781	20,398	21,395
Reported net profit (CNYm)	3,096	3,483	3,203	3,253	3,009
Recurring net profit (CNYm)	3,096	3,483	3,203	3,253	3,008
Recurring net profit growth (%)	(13.5)	12.5	(8.0)	1.6	(7.5)
Recurring EPS (CNY)	0.81	0.91	0.83	0.85	0.78
DPS (CNY)	0.24	0.24	0.24	0.24	0.24
Recurring P/E (x)	7.07	6.28	6.83	6.73	7.28
P/B (x)	1.23	1.07	0.97	0.88	0.82
P/CF (x)	na	2.40	9.58	8.35	8.68
Dividend Yield (%)	4.3	4.3	4.3	4.3	4.3
EV/EBITDA (x)	3.56	3.87	3.28	3.28	3.40
Return on average equity (%)	18.6	18.2	14.9	13.7	11.7
Net debt to equity (%)	19.3	9.8	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			5.7	9.7	6.1

Source: Company data, RHB

Additional Notes

Figure 1: Quarterly results in review

CNYm	3Q14	2Q15	3Q15	YoY	QoQ	Reasons
Shipbuilding related	3,078	3,759	3,345	9%	-11%	High revenue recognitions as yards are operating at full capacity, with larger containerships under construction. Lower QoQ due to normal S-curve recognition fluctuations.
Trading and others	232	1,470	431	86%	-71%	Arbitrage operations in steel, iron ore, other commodities.
Investments	407	446	336	-18%	-25%	
Micro Financing	26	35	24	-7%	-30%	
Revenue	3,743	5,710	4,136	10%	-28%	
Cost of sales	(2,679)	(4,680)	(3,159)	18%	-33%	3Q15 gross profit only fell 5% even as revenue fell 28%, due to margin expansion resulting from stronger USD vs CNY. Gains here offset by currency hedge losses.
Gross profit	1,064	1,030	977	-8%	-5%	
Other income	69	65	40	-42%	-39%	
Other income, net	75	412	242	nm	-41%	2Q15: CNY157m gain from available from sale assets, CNY155m mark-to-market gains on derivatives, and CNY124m subsidy from government (tax rebates), CNY26m provisions for HTM assets as per usual conservative accounting. 3Q15: CNY562m of subsidies offset by CNY207m of losses on A-shares, CNY100m loss on disposal of subsidiary, and forex losses.
Administrative expenses	(89)	(91)	(72)	-19%	-21%	
Finance costs	(95)	(66)	(222)	nm	nm	3Q15: CNY130m of translation losses on USD debt.
Share of profit / (loss) from JV	2	0	4	55%	nm	
Profit before tax	1,026	1,350	968	-6%	-28%	
Income tax expense	(214)	(310)	(278)	30%	-10%	Taxes on shipbuilding operations only. Mark-to-market losses at the list-co do not receive tax credits.
Minority interest	(1)	(9)	(10)	nm	15%	
PATMI	811	1,031	681	-16%	-34%	Stripping out gains on sale and derivative gains, 2Q15 core PATMI was CNY719m. 3Q15 PATMI substantially affected by accounting losses like loss on A-shares, reversing gains in 1H15, debt translation losses, and currency hedges (which hedge against future order-book income in USD).

Group gross margin	28.4%	18.0%	23.6%		
Net margin	21.7%	18.0%	16.5%		
Gross Profits					
Shipbuilding related	650	555	619	-5%	11%
Trading and others	8	30	9	15%	-71%
Investments	381	412	326	-14%	-21%
Micro Financing	25	33	24	-7%	-28%
Gross Margins					
Shipyards related	21.1%	14.8%	18.5%		Shipbuilding margin in 3Q15 higher than expected, largely due to weaker CNY as vessels sold are denominated in USD.
Trading and others	0.2%	0.8%	0.3%		
Investments	93.6%	92.3%	97.1%		
Micro Financing	96.6%	94.3%	96.6%		

Source: Company data, RHB

Figure 2: SOP valuation

Sum of the parts	2015	Remarks
Gross cash	8,639	Est end FY15
Financial assets	10,788	1x est. end FY15
Properties and other investments	2,697	Est end FY15
Gross debt	-8,000	Est end FY15
Sub-total	14,124	
Shipbuilding	13,552	6x shipbuilding earnings in FY15
Equity value (CNYm)	27,676	
Equity value (SGDm)	6,150	CNY4.50 per SGD
No of shares	3,832	
Equity value per share	1.61	
Model Equity value	27,676	
2015 Est Earnings (CNYm)	3,203	
Model implied P/E on 2015 earnings	8.6	
Dividends per share assumption (SGD)	0.06	
Implied dividend yield at fair value	3.43%	

Source: RHB

Chairman Renditions

Chairman Mr Ren Yuanlin, in his usual humorous and candid manner, gave a comprehensive review on his strategy for the company and on the overall shipbuilding industry. Here are our key takeaways, in Mr Ren Yuanlin's own words (note that any translation errors would be ours):

On the global economy. *“Europe, Asia, including China are all slowing down. Small and medium enterprises are under pressure. Shipbuilding and maritime activities are directly linked to the global macro picture. Many companies are losing money, and the number of bankrupt shipyards is going up. If the Korean government didn't support [them], Samsung, etc. could have collapsed.”*

On avoiding pitfalls. *“In 2011-2012, we wanted to move towards developing drilling assets, offshore platforms, and other oil & gas related assets like what Shanghai Waigaoqiao, Raffles Yantai, Nantong, etc did. If we had taken 4-5 jack-ups then, analysts might not even want to attend our results briefing anymore! After taking one order, we realised it was a high-risk activity. We had more potential orders, but did not let them follow-through to completion as payment terms were very bad. Now, Waigaoqiao has 11 rigs that nobody wants.”*

On stringent order-taking criteria. *“We are targeting large containerships, but will also be signing a couple of small 1000-2000TEU containerships soon. Our growth direction is towards clean-energy vessels like liquefied natural gas (LNG) carriers and VLGCs. We will not sign the contract if: i) losses can be expected at the gross level, ii) deposits are extremely low, or iii) the ship is too technically difficult to build (big LNG vessels or intercontinental cruise ships, etc.)”*

On the gas carrier market. *“Dalian cannot build LNG vessels. This market is mostly served by Korean and Japanese builders. There are few builders in China for LPG/LNG vessels. President Xi Jinping's 13th 5-year plan for China requires green energy. Iran has a lot of natural gas, and aims to export to China. Coal-fired power plants are being closed, while solar and natural gas power plants are coming up. We cannot say how big the market is, nor what margins we will achieve on the vessels, but this is a direction we are confident to develop towards, and we are building our track record with each vessel.”*

On M&A criteria. *“i) We will take opportunities, but will not actively seek/create them. ii) Targets must be complementary to current shipbuilding business. iii) It must make financial sense. If we really need money for investments we can consider dual-listing in Hong Kong, but the A-share market is simply unfeasible.”*

On Yangzijiang's financial strength. *“Our financial position is so strong that banks do not even ask for collateral from us. We won't go into capital-intensive businesses or assets with high cash-burn rates. Our fixed assets are only one-third that of our peers – we own no buildings in Singapore, nor hotels nor restaurants in China.”*

On the Shanghai Chengding investment and other public-private opportunities. *“The Government owns 70% and YZJ owns 30% of this venture equity fund, targeted at the state-owned-enterprise (SOE) restructuring programme. The Government welcomes private owners and YZJ is seen as a strong candidate in this field. President Xi is encouraging a hybrid economy [of public and private enterprises]. We have also taken a 25% stake in the management-co of this fund, so we have a Golden Vote and no investment can proceed without our agreement. We will be focusing more on such investments, redirecting funds from held-to-maturity (HTM) assets, perhaps even for the latter to approach zero. These are large government-backed projects, part of the new hybrid economy, whereas the profile of HTM borrowers is gradually deteriorating as the economy slows. We will take more of such public-private investment projects, all at the associate level.”*

Financial Exhibits

Profit & Loss (CNYm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover	14,339	15,354	18,781	20,398	21,395
Cost of sales	(9,577)	(11,210)	(14,603)	(16,112)	(17,659)
Gross profit	4,762	4,144	4,178	4,286	3,736
Gen & admin expenses	(352)	(435)	(420)	(380)	(380)
Other operating costs	193	481	762	450	650
Operating profit	4,602	4,190	4,519	4,356	4,006
Operating EBITDA	4,887	4,600	4,959	4,777	4,432
Depreciation of fixed assets	(285)	(410)	(440)	(421)	(426)
Operating EBIT	4,602	4,190	4,519	4,356	4,006
Net income from investments	(1)	8	10	20	20
Interest income	259	-	61	69	80
Interest expense	(241)	(245)	(389)	(233)	(210)
Exceptional income - net	-	-	-	-	1
Pre-tax profit	4,620	3,953	4,202	4,212	3,896
Taxation	(1,542)	(472)	(966)	(927)	(857)
Minority interests	18	2	(32)	(33)	(30)
Profit after tax & minorities	3,096	3,483	3,203	3,253	3,009
Reported net profit	3,096	3,483	3,203	3,253	3,009
Recurring net profit	3,096	3,483	3,203	3,253	3,008

Source: Company data, RHB

Cash flow (CNYm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Operating profit	4,602	4,190	4,519	4,356	4,006
Depreciation & amortisation	285	410	440	421	426
Change in working capital	(1,229)	(1,595)	(102)	(1,066)	(925)
Other operating cash flow	(6,326)	6,891	(1,279)	(0)	1
Operating cash flow	(2,668)	9,896	3,578	3,712	3,508
Interest received	-	-	61	69	80
Interest paid	-	(321)	(389)	(233)	(210)
Dividends received	21	31	-	-	-
Tax paid	(1,001)	(492)	(966)	(927)	(857)
Cash flow from operations	(3,648)	9,113	2,284	2,621	2,521
Capex	(1,031)	(729)	(300)	(500)	(500)
Other new investments	(115)	(1,573)	791	500	0
Other investing cash flow	9	908	1,000	-	(0)
Cash flow from investing activities	(1,137)	(1,395)	1,491	0	(500)
Dividends paid	(936)	(960)	(1,064)	(1,064)	(1,064)
Proceeds from issue of shares	91	-	-	-	-
Increase in debt	5,206	(5,523)	(50)	(500)	(1,000)
Other financing cash flow	(227)	(19)	-	-	(0)
Cash flow from financing activities	4,134	(6,502)	(1,115)	(1,564)	(2,064)
Cash at beginning of period	2,087	1,436	2,653	5,313	6,370
Total cash generated	(650)	1,216	2,660	1,057	(44)
Implied cash at end of period	1,436	2,653	5,313	6,370	6,326

Source: Company data, RHB

Financial Exhibits

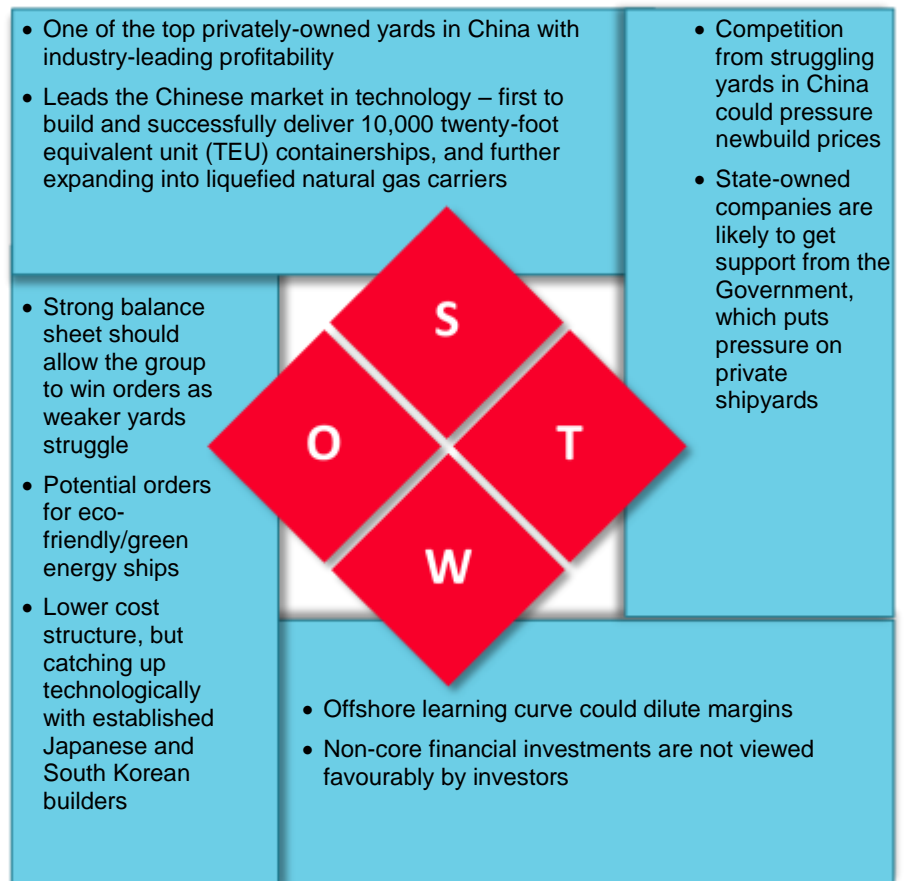
Balance Sheet (CNYm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total cash and equivalents	9,853	5,978	8,639	9,696	9,652
Inventories	1,463	2,015	1,544	2,235	2,931
Accounts receivable	6,879	6,721	7,718	8,383	8,792
Other current assets	9,893	11,048	9,438	9,590	9,684
Total current assets	28,089	25,762	27,338	29,904	31,059
Total investments	6,899	6,321	5,819	5,339	5,359
Tangible fixed assets	6,884	7,249	7,109	7,188	7,262
Intangible assets	0	2	2	2	2
Total other assets	1,339	1,443	1,443	1,443	1,443
Total non-current assets	15,122	15,016	14,373	13,972	14,066
Total assets	43,211	40,778	41,712	43,876	45,125
Short-term debt	12,241	5,414	3,500	3,500	2,500
Accounts payable	5,633	5,723	5,145	5,589	5,862
Other current liabilities	4,568	4,227	3,618	3,618	3,619
Total current liabilities	22,442	15,364	12,263	12,706	11,980
Total long-term debt	1,133	2,636	4,500	4,000	4,000
Other liabilities	1,363	1,702	1,702	1,702	1,702
Total non-current liabilities	2,496	4,338	6,202	5,702	5,702
Total liabilities	24,938	19,702	18,465	18,408	17,682
Share capital	6,333	6,263	6,263	6,263	6,263
Retained earnings reserve	11,468	14,210	16,349	18,538	20,482
Shareholders' equity	17,801	20,473	22,612	24,801	26,745
Minority interests	472	603	635	668	698
Other equity	-	(0)	0	0	(0)
Total equity	18,273	21,076	23,247	25,468	27,443
Total liabilities & equity	43,211	40,778	41,712	43,876	45,125

Source: Company data, RHB

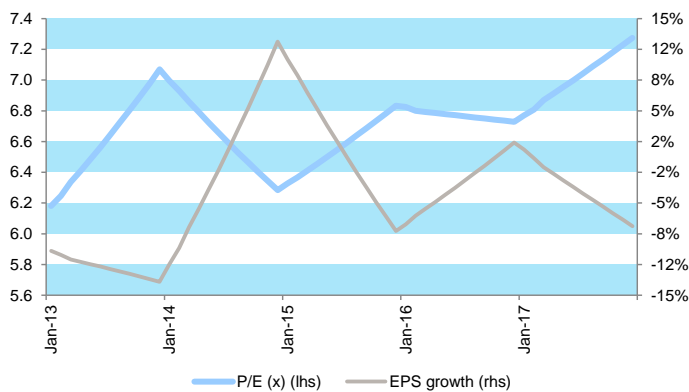
Key Ratios (CNY)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Revenue growth (%)	(3.1)	7.1	22.3	8.6	4.9
Operating profit growth (%)	(0.1)	(9.0)	7.9	(3.6)	(8.0)
Net profit growth (%)	(13.5)	12.5	(8.0)	1.6	(7.5)
EPS growth (%)	(13.5)	12.5	(8.0)	1.6	(7.5)
BVPS growth (%)	14.8	15.0	10.4	9.7	7.8
Operating margin (%)	32.1	27.3	24.1	21.4	18.7
Net profit margin (%)	21.6	22.7	17.1	15.9	14.1
Return on average assets (%)	8.1	8.3	7.8	7.6	6.8
Return on average equity (%)	18.6	18.2	14.9	13.7	11.7
Net debt to equity (%)	19.3	9.8	(2.7)	(8.6)	(11.5)
DPS	0.24	0.24	0.24	0.24	0.24
Recurrent cash flow per share	(0.95)	2.38	0.60	0.68	0.66

Source: Company data, RHB

SWOT Analysis

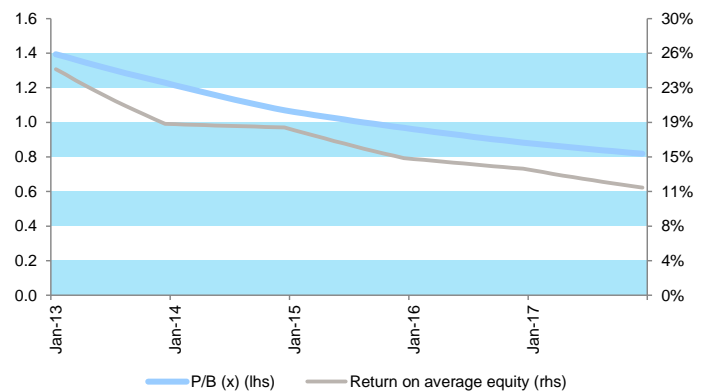


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE



Source: Company data, RHB

Company Profile

Yangzijiang is a leading non-state owned shipbuilder in China with expertise in containership and bulk cargo carriers, and is also spearheading Chinese shipyards' move into gas carriers. It is the single most profitable shipyard in China with the lowest cost structure.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-08-06	Buy	1.68	1.26
2015-05-05	Buy	1.92	1.44
2015-03-02	Buy	1.68	1.21
2014-08-06	Buy	1.68	1.10
2014-04-30	Buy	1.55	1.10
2014-04-02	Buy	1.58	1.11
2014-03-20	Buy	1.58	1.07
2014-02-28	Buy	1.55	1.14
2013-11-14	Buy	1.50	1.16
2013-10-02	Buy	1.45	1.14

Source : RHB, Bloomberg

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