



Asia Cement Corp. (1102 TT)

HOLD

Cement

Company Update

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Recommendation

HOLD

Date: October 24, 2005

Share Price (NT\$): 17.20

Price Target (NT\$): 18.20

Percent Change: 5.8%

52-wk range (NT\$): 19.83-16.73

TWSE: 5717.28

Company Data

Capital Size (NT\$): 23.45bn

Market Cap (NT\$): 40.33bn

Market Cap (US\$): 1.19bn

Outstanding Shrs: 2.34bn

PER ('05E): 6.49x

PBR ('05E) 0.85x

Foreign Ownership: 7.09%

Major Shareholder: Far Eastern Textile
(24.05%)**Performance**

	1-m	3-m	6-m
Absolute (%)	(5.75)	(7.38)	1.47
Relative to TAIEX	(2.32)	4.01	2.20

Key Changes

	Current	Prev.
Recommendation	HOLD	N/A
Price Target (NT\$)	18.20	N/A
Revenue (NT\$bn)	10.82	N/A
Gross Margin (%)	22.50	N/A
Oper. Margin (%)	19.00	N/A
EPS (NT\$)	2.43	N/A

Price Catalysts (+,-)

(-) Limited upside from Hurricane Katrina Reconstruction

(-) Tepid domestic cement demand

Related Research

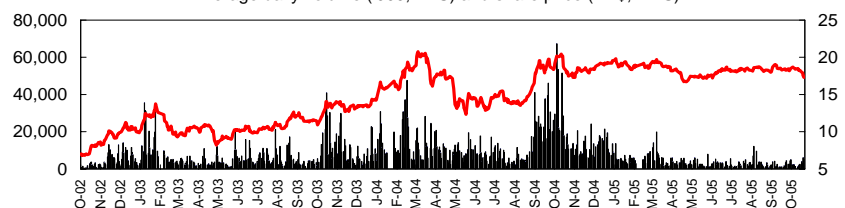
Taiwan Cement (1101 TT) Sep. 27, 2005

Chia Hsin Cement (1103 TT) Mar. 09, 2005

Unexciting 2006 Outlook

- **Limited upside from Hurricane Katrina reconstruction.** Since Asia Cement Corp.'s (ACC) exports to U.S. only account for 6% of its total sales, we believe the reconstruction after Hurricane Katrina is unlikely to have significant contribution to ACC. Furthermore, ACC's gross margin from the domestic market, 20%, is higher than the gross margin from exports, 10%. Therefore, ACC should continue to focus on the domestic business regardless the surging demand in the global market.
- **Tepid domestic cement demand.** Due to the slowing down real estate market and no major spending on public construction in 2006, we expect the domestic demand for cement to remain flat and the ASP of cement to stay at NT\$2,150 per metric ton (mt.). As a result, ACC's 2006 sales are estimated to close at NT\$10.7bn, with gross margin above 20%.
- **Steady China production.** We believe Chinese cement market will remain oversupplied in 2006; therefore, cement ASP and gross margin will stay at its low-end range. With no major capacity expansions in the next year, we believe the contribution from Chinese production to ACC will remain unchanged in 2006 as well.
- **Lower non-operating income compare to 2004.** We expect weaker profitability for ACC in 2006, because 1) non-operating income is expected to decrease from 2004 (non-operating income accounted for 76% of ACC's net income in 2004) and 2) further investment write-off loss from Article 34. In our forecast, Article 34 alone will lower ACC's 2006E EPS by NT\$0.23 to NT\$2.42.
- **HOLD.** ACC historically has been traded between 0.60-1.05x PBR and is currently traded at 0.85x PBR based on 2005E BVPS of NT\$20.22. Due to the reasons mentioned above, we hold a conservative view on the company's outlook. Based on a 0.90x PBR of 2005E BVPS, we conclude a target price of NT\$18.20, suggesting a 5.8% upside potential, thus recommend to HOLD.

Average daily volume ('000, LHS) and share price (NT\$, RHS)



Relative to TAIEX (%)



Investment Keynotes

Company background

Established in 1957, Asian Cement Corp. (ACC) is Taiwan's second largest cement provider, trailing after Taiwan Cement (1101 TT, NT\$20.15, BUY). ACC manufactures and distributes cement, semi-finished cement, and ready-mixed concrete products. Its export to domestic market ratio sits at 3:7. ACC is also a member of Asia Conglomerate, which includes U-Ming Marine (2606 TT, NT\$33.40, HOLD), Far Eastern Textile (1402 TT, NT\$18.00, NR), and Far Eastern Tone (4904 TT, NT\$37.85, NR).

Limited upside from Hurricane Katrina reconstruction

Due to the reconstruction demand after Hurricane Katrina, we expect Taiwanese cement exports to increase and ACC to raise its cement ASP by 5-10%. However, the event is unlikely to have significant contribution to ACC, because exports to the U.S. only account for 6% of its total sales. ACC's exports focus on South America with FOB of US\$32-33 per metric ton (mt.), while Taiwan Cement's main market is located in western United States with FOB of US\$40 per mt. ACC's average gross margin from export is below 10%, so the 5-10% ASP hike will lead to limited margin improvement. Moreover, since ACC's gross margin from the domestic market is higher at 20%, we expect the company to continue to focus on the domestic business regardless the surging demand in the global market.

Figure 1: ACC vs. Taiwan Cement

Company	Sales (NT\$ mn)			EPS (NT\$)		
	2004	2005E	YoY	2004	2005E	YoY
ACC	10,405	10,729	3.1%	2.97	2.65	-10.8%
Taiwan Cement	27,916	29,214	4.6%	1.69	1.95	-15.38%

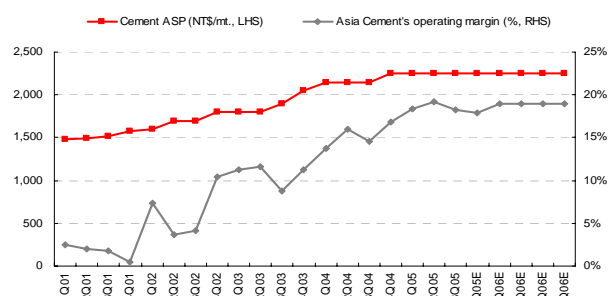
Source: Company data; MasterLink Securities

Tepid domestic cement demand

ACC's 2006 sales are estimated to be at the 2005 level due to the slowing domestic market. Firstly, with real estate market hitting the peak, we expect the growth rate of building permit to fall from 72% YoY in 2004 to 15% YoY in 2005. The growth rate in 2006 will also be at the 2005 level. Secondly, due to budget deficit, we believe

the government will have no major spending on public construction in 2006. Therefore, we expect the domestic demand for cement in 2006 to remain flat and the ASP of cement to stay at NT\$2,150 per mt. ACC's 2006 sales is estimated to close at NT\$10.7bn with gross margin expected to stay above 20%.

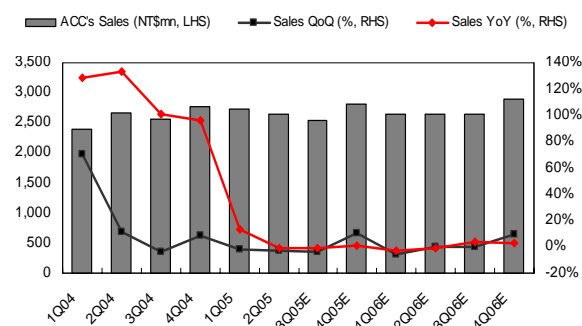
Figure 2: Cement ASP vs. ACC's Operating Margin



Source: Company data; MasterLink Securities

ACC's accumulated sales from the first three quarters in 2005 closed at NT\$7.9bn, up 3.9% YoY. Since the cement ASP remains strong in the domestic market and the coal price keeps on rising, the gross margin has increased from 19% to 23%. As a result, the accumulated operating income between 1Q05 and 3Q05 jumped 39.5% YoY to NT\$1.48bn.

Figure 3: ACC's Quarterly Sales



Source: TEJ; MasterLink Securities

Steady China production

ACC has two factories in mass production in China: Ya Tung Cement in Jiang Xi Province and Ya Tung Cement in Hu Bei Province, each with an annual capacity of 3.2mn mt. and 1.75mn mt., respectively. Another factory, Ya Tung Cement in Si Chuan Province will enter into production in 3Q06 with a capacity of 1.6mn mt. per year.

With the total shipment estimated to stay flat, we expect the profit generated from China production will stay flat in 2006 as well. However, Ya Tung Cement in Jiang Xi will increase its capacity by another 1.6mn mt. in 2007, raising ACC's total annual capacity to 13.5mn mt.

Figure 4: ACC's Chinese Capacity Expansion Plan (Unit: mn mt.)

Factory	2004	2005E	2006E	2007E
Hu Bei	1.75	1.75	1.75	1.75
Jiang Xi	3.20	3.20	3.20	4.80
Si Chuan	-	-	1.60	1.60
Total China production	4.95	4.95	6.55	8.15
Total Taiwan Production	5.35	5.35	5.35	5.35
Total ACC Production	10.30	10.30	11.90	13.50

Source: Company data; MasterLink Securities

We observed a continuously declining cement ASP in China due to oversupply. The cement ASP in Jiang Xi Province has plunged from RMB360 per mt. in 1Q04 to RMB260 in 3Q05. Meanwhile, The gross margin from Ya Tung Cement in Jiang Xi Province also fall from 35% to the current 15%. We believe the cement market will remain oversupplied in 2006; therefore, cement ASP and gross margin will stay at its low-end range. With no major capacity expansion next year, we believe the contribution from Chinese production will remain unchanged in 2006 as well.

Lower non-operating income compare to 2004

In 2004, 76% of ACC's net income came from non-operating income, in which 65% came from long-term investment in U-Ming Marine and Far Eastern Textile. ACC has booked a total of NT\$3.1bn from U-Ming Marine and Far Eastern Textile between 1Q05 and 3Q05, down from NT\$3.6bn during the same time last year. Another major contribution for ACC's non-operating income is its China production, which also slid down between 1Q05 and 3Q05.

Looking into 2006, we expect weaker profitability for ACC because 1) long-term investment in U-Ming Marine and Far Eastern Textile is expected to decrease from 2004, 2) further investment write-off loss due to Article 34. In our forecast, Article 34 alone will lower ACC's 2006E EPS by NT\$0.23 to NT\$2.42.

Valuations and Recommendation

ACC historically has been traded between 0.60-1.05x PBR and is currently trading at 0.85x PBR based on 2005E BVPS of NT\$20.22. With 1) limited upside from Hurricane Katrina reconstruction demand, 2) tepid domestic cement demand, 3) steady China production, and 4) lower non-operating income compare to 2004, we hold a conservative view on the company's outlook for the next three months. Therefore, based on a 0.9x PBR of 2005E BVPS, we conclude a target price of NT\$18.20 suggesting a 5.8% upside potential, thus recommend to HOLD.

Figure 5: ACC's P/B Band



Source: TEJ; MasterLink Securities

Figure 6: Statement of Operations (NT\$ mn)

Year to December	2003	2004	2005E	2006E
Revenue	9,569	10,405	10,729	10,815
Cost of Goods Sold	8,191	8,400	8,366	8,382
Gross Profit	1,378	2,005	2,363	2,433
Operating Exp.	355	401	385	379
Operating Income	1,028	1,601	1,976	2,055
Non-op. Income	3,883	6,178	5,312	4,164
Non-op. Exp.	1,445	1,047	765	120
Pretax Income	3,466	6,732	6,522	6,099
Net Income	3,321	6,438	6,212	5,691
Adjusted EPS (NT\$)	1.63	2.97	2.65	2.43

Source: MasterLink Securities

Figure 7: Income Statement (%)

Year to December	2003	2004	2005E	2006E
Gross Profit	14.40	19.27	22.02	22.50
Operating Exp.	3.71	3.86	3.59	3.50
Operating Income	10.74	15.38	18.42	19.00
EBIT	36.22	64.70	60.79	56.40

Source: MasterLink Securities

Figure 8: Income Statement (% Growth)

Year to December	2003	2004	2005E	2006E
Revenue	(13.99)	8.74	3.12	0.80
Pretax Income	162.15	94.24	(3.12)	(6.48)
Net Income	186.26	93.87	(3.51)	(8.39)

Source: MasterLink Securities

Figure 9: Statement of Operations (NT\$m)

Quarter	1Q05	2Q05	3Q05E	4Q05E
Revenue	2,727	2,650	2,539	2,814
Cost of Goods Sold	2,129	2,041	1,988	2,209
Gross Profit	598	609	551	605
Operating Exp.	97	98	89	101
Operating Income	501	509	462	504
Non-op. Income	1,373	1,652	1,167	1,119
Non-op. Exp.	349	142	131	144
Pretax Income	1,525	2,019	1,498	1,479
Net Income	1,448	1,906	1,438	1,420
Adjusted EPS (NT\$)	0.62	0.81	0.61	0.61

Source: MasterLink Securities

MasterLink Securities – Stock Rating System**BUY:** Total return expected to appreciate 10% or more over a 3-month period.**HOLD:** Total return expected to be between 10% to –10% over a 3-month period.**SELL:** Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request

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