Shengdatech (SDTH)

Raimondas Lencevicius

Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Shengdatech – business

- Nano precipitated calcium carbonate ("NPCC") products – additives:
  - Tire (43%)
  - Polyvinyl chloride (PVC) building materials (37%)
  - Adhesive (10%)
  - Ink + Paint(4%), latex (4%), paper (1%) and polyethylene (PE) industries
  - Enhanced performance, reduced price
- Coal-based chemical products
  - Ammonium bicarbonate, liquid ammonia, methanol and melamine
  - Discontinued November 2008 due to Chinese government zoning regulation shutdown of factory

Shengdatech – NPCC business

- 190,000 metric tons as of December 2008
- New facility in Zibo, Shandong Province projected capacity of 240,000 metric tons
- Largest Chinese manufacturer of NPCC products – claims 47.4%, but…
  - ShengdaTech, Inc. 190,000 - 26%!
  - Jiawei 170,000
  - Tianze 100,000
  - Yaohua 50,000
  - Guangping 30,000
  - CZ Calicum Carbonate 20,000
  - Keli 20,000
  - Perfection 15,000
  - BJ Chemical Building Material 14,000
  - Others 125,000
- Sales and earnings growth 40%+ in 2008 in NPCC
- R&D, University collaboration

Shengdatech – Various pros and cons

- Reverse merger listing, Bermuda, Chinese subsidiaries
  - Red flag in general, but pretty common in Chinese small-caps
- Lost coal-based chemical business in 2008
  - 45% of sales
  - Even at 40% NPCC growth, only 50% of chemical revenues would be replaced
- Planned to purchase fertilizer company, plan cancelled
  - Pretty neutral, due to large commodity price swings and global slowdown

Is it a good business?

- 5 year history of profits
- ROE:
  - 30 30 2008:29
- Margins
  - 24 27 2008: 27
- Strong balance sheet
  - Zero debt (~114M cash – 95M convertibles at ~$9)
  - 136 book = net tangible assets, only ~20M net current assets
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - Almost equal ROE

Is it a good business?

- Bought back preferred shares at 50% discount to par
- Cash flow negative after investments in business (operating cash flow – investing cash flow) for last 2 years
    - Normal for 40%+ revenue and earnings growth

Is business cheap?

- ROE 20%
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $140M
- Equity in 10 years = Equity*$(1+ROE)^9$ = 701M
- Market cap = 701M x P/E (15) = $2102M
- Rate of return = ~24% after tax (calculations omitted)
- If we assume 15% ROE: 16%

- Uses starting earnings of 27M < 40M actual

- 1.44 P/Book – not a net net

Is business cheap?

- Discounted cash flow
  - Current earnings of 40M*0.55 = ~22M
  - 40% growth for 5 years, leveling after that
    - 10% discount -> $974M current valuation
    - 20% discount -> $400M current valuation
  - 20% growth for 5 years, leveling after that
    - 10% discount -> $480M current valuation
    - 20% discount -> $220M current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 40M / (136M + 95M – 114M) = 23%
  - 40M*.55 / (136M + 95M – 114M) = 12.5%