

JPM-pp1

Asia Pacific Equity Research

26 March 2015

Maanshan Iron & Steel - H (323 HK)

Overweight

Price: HK\$2.12

25 Mar 2015

Price Target: HK\$2.00

PT End Date: 31 Dec 2015

First take FY2014 results - Beat, slow start to 2015

Maanshan (Magang)'s FY14 results beat expectations, revealing a solid 2H rebound. Guidance for volume to grow by 7% should help but the recent sharp contraction in cash spreads (from 4Q levels), may see 1Q15 back to breakeven or even slipping into losses. The good news is that cash spreads now appear to be bottoming as we walk into the 2Q construction season. We view Magang as a beneficiary of China's infrastructure policies and are currently OW rated.

Key Highlights

- **FY14 results beat, boosted by government grants and lower depreciation.** Magang posted FY14 net profit (NP) of Rmb220m, beating consensus estimates (JPM Rmb156m, Street RMB77m). Following a 1H14 net loss of RMB 730m, this was a commendable effort. That said, the result was heavily boosted by government subsidies and lower depreciation charges. Excluding these non-recurring items, we estimate the company remained in losses of Rmb156m for FY14. At the core level, we estimate Magang's 4Q14 NP of RMB259m, -31% q/q. On a positive note, FY14 FCF improved to RMB313m, helping net gearing (ND/E) ease to 71% (end 2014 from 77% in 2013).
- **Steel markets to remain challenging, guidance for 7% volume growth.** Maanshan expects the steel market to remain challenging in 2015 as China enters a "new norm" with the steel industry in oversupply and demand slowing. Capex is forecast to be marginally lower at Rmb2.5B while product output is expected to be 19.6mt, +7% y/y. The company did not provide specific profit guidance but we note that 1Q15 HRC and rebar cash spreads have fallen by 15% and 17% q/q, suggesting a weak start to the year.

Impact

- Given its earnings beat, we expect the market to generally receive the result well.

Table 1: Maanshan FY14 quarterly results

(Rmb Mil)	Q3 13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	QoQ% 4Q14	YoY% 4Q14
Principal revenue	19,440	17,457	73,849	13,644	15,221	15,569	15,388	59,821	-1%	-12%
Less principal operating cost	-18,454	-16,696	-70,394	-13,157	-14,666	-14,156	-13,861	-55,840	2%	-17%
Less sales tax	-55	-36	-226	-45	-48	-73	-70	-235	4%	94%
Principal operating profit	930	725	3,228	442	507	1,340	1,457	3,745	9%	101%
add other operating profit	0	0	0	0	0	0	0	0	nm	0%
less selling expenses	-105	-134	-423	-104	-128	-130	-152	-513	-17%	13%
less administrative expenses	-345	-305	-1,334	-306	-293	-350	-363	-1,311	-4%	19%
less financial expenses	-287	-241	-1,154	-365	-329	-310	-240	-1,244	22%	0%
asset impairment charges	-187	-499	-1,164	-186	-159	-187	-240	-770	-28%	-52%
Sub-total for SG & A	-925	-1,180	-4,076	-960	-908	-976	-995	-3,837	-2%	-16%
Investment income/(loss)	35	185	289	37	37	36	39	150	7%	-79%
Net operating profit	40	-270	-558	-481	-363	401	501	58	25%	nm
Non-operating income	28	776	888	59	42	36	404	541	1027%	-48%
Less: non-operating expenses	1	-5	-8	-1	-1	-1	-83	-87	-5789%	1497%
Profit before tax	68	500	322	-422	-322	435	821	512	89%	64%
Tax	-42	5	-114	-56	37	-29	-200	-248	-581%	nm
MI	-23	-19	-51	32	1	-2	-75	-43	-4343%	305%
Net profit	3	487	157	-446	-284	404	546	220	35%	12%
Non recurring gains or losses										
Core NPAT	(677)	625	(446)	(480)	(312)	378	259	(156)	-31%	-59%
EPS (Rmb)	0.00	0.06	0.02	-0.06	-0.04	0.05	0.07	0.03	35%	12%
Margin										
Principal operating profit	4.8%	4.2%	4.4%	3.2%	3.3%	8.6%	9.5%	6.3%	1pps	5pps
Net operating profit	0.2%	-1.5%	-0.8%	-3.5%	-2.4%	2.6%	3.3%	0.1%	1pps	5pps
Profit before tax	0.4%	2.9%	0.4%	-3.1%	-2.1%	2.8%	5.3%	0.9%	3pps	2pps
Net profit margin	0.0%	2.8%	0.2%	-3.3%	-1.9%	2.6%	3.6%	0.4%	1pps	1pps
Tax rate	61.8%	-1.0%	35.5%	-13.3%	11.6%	6.8%	24.4%	48.5%	18pps	25pps
Cash flow analysis										
Operating cash flow	326	1,006	5,091	-523	1,911	1,525	-1	2,913	nm	nm
Investment cash flow	-2,529	878	-4,543	1,728	80	-281	-2,853	-1,326	-915%	nm
Capex	-1,482	-720	-5,521	-923	54	-1,448	-283	-2,599	80%	-61%
FCF	-1,156	287	-429	-1,445	1,964	78	-283	313	nm	nm
						46				
GP/t	198	154	179	111	108	277	301	203	9%	95%
NP/t	1	104	9	-112	-61	83	113	12	35%	9%

Source: Company data, J.P. Morgan

Investment Thesis

Maanshan is one of China's leading steel producers. Its product mix is broadly equally split between flats and long steels. This exposure to long steel (50% of sales) provides Maanshan with substantial leverage to China's urbanization policy and affordable housing strategy. With valuations close to historical lows, we see attractive risk-reward and remain OW rated.

Valuation

Our Dec-15 price target for Maanshan-H of HK\$2.0 is based on a 2015E P/BV of 0.5x, in line with that of its peers.

Risks to Rating and Price Target

Upside risks

- Amendments to government policy relating to the domestic steel industry, especially on output capacity cuts
- Lower-than-expected cost pressure
- Higher-than-expected product prices

Downside risks

- Higher-than-expected cost pressure
- Lower-than-expected product prices
- Chinese Ministry of Rail fails to approve the company's high-speed train wheels.

Asia Metals and Mining

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07-Nov-06	OW	3.41	4.25
20-Dec-06	OW	4.36	4.80
16-Jan-07	OW	4.76	5.50
22-Feb-07	OW	5.33	7.00
23-Jul-07	OW	6.35	8.50
17-Aug-07	OW	5.50	8.20
29-Oct-07	N	7.53	7.30
20-Feb-08	N	4.60	6.00
03-Jun-08	N	5.85	7.00
15-Aug-08	N	3.51	6.00
15-Oct-08	N	1.72	5.50
11-Nov-08	N	2.26	3.73
05-Mar-09	N	2.48	2.90
09-Jun-09	OW	5.00	6.20
31-Jul-09	OW	5.88	7.70
28-Oct-09	OW	5.09	5.60
22-Jan-10	UW	5.00	4.00
10-Aug-10	OW	4.24	5.35
12-Oct-10	N	4.99	5.35
06-Aug-11	N	3.24	3.00
21-Oct-11	N	1.92	2.10
20-Jan-12	N	2.96	3.40
19-Apr-12	N	2.42	2.90
30-Jul-12	OW	1.67	2.20
31-Jan-13	UW	2.61	2.20
27-Mar-13	UW	2.11	1.90
28-Apr-13	UW	1.92	1.70
07-Aug-13	N	1.97	2.20
28-Mar-14	OW	1.63	2.00

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=503617&shareClassServerId=4&chartDesignation=1&actionType=C>

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