

JPM-pp1

Asia Pacific Equity Research

30 March 2015

# Angang Steel - H (347 HK)

Neutral

Price: HK\$5.65

30 Mar 2015

Price Target: HK\$6.00

PT End Date: 31 Dec 2015

First take FY14 results miss, 1Q15 likely slips into losses

Angang's FY14 results (net profit of Rmb928m, +21% y/y) missed market expectations (Rmb1.2b). With 4Q14 barely breakeven, a 3-4% cut to 4M15 contract prices may see 1Q15 slipping into losses. With Angang at a 0.7x P/B, we view it as fairly valued and stay Neutral.

## Key highlights

- FY14 results miss.** Angang reported weak FY14 results, with net income of Rmb928m (+21% y/y) falling short of consensus of Rmb1.2b. Key factors behind the miss, in our view, were weak revenue (-2% y/y) and higher selling expenses (+27% y/y). We estimate that 4Q14 was barely breakeven, at Rmb5m (-99% q/q). Furthermore, we estimate that negative FCF of Rmb2.3b pushed net gearing (ND/E) higher, to 42% (2013: 35%). Pleasingly, DPS was hiked by 67%, to Rmb5 cents, with the payout ratio up to 35% (2013: 25%).
- Steel markets to remain challenging.** For 2015, Angang did not provide specific production or profit targets. The company believes policy support from robust infrastructure spending and the "One Belt One Road" development strategy will keep domestic steel demand steady. However, overcapacity, environmental enforcement and the adjustment of export tax rebates will keep domestic steel markets under pressure.
- Weak start to 1Q15.** Looking at Angang's key product pricing for 4M15, we note that contract prices for key products are 3-4% lower than in 4Q14, while iron ore costs are 2% higher. A fall in cash spreads (from 4Q levels) may see 1Q15 slipping into losses, by our estimates.

## Stock impact

Given Angang's earnings miss, we expect a negative market response and consensus downgrades.

## Investor briefing

Date: 1 April 2015 (Wednesday)

Time: 4:00-5:00 p.m.

Venue: Boardroom A, Level 5, Island Shangri-La HK, Two Pacific Place, Central, Hong Kong

Medium: Mandarin, and English interpretation.

Table 1: Angang FY14 results summary (PRC GAAP)

Rmb in millions	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	QoQ% 4Q14	YoY% 4Q14	YoY% 2014
<b>Principal revenue</b>	<b>19,168</b>	<b>17,754</b>	<b>19,238</b>	<b>19,169</b>	<b>75,329</b>	<b>18,399</b>	<b>19,778</b>	<b>19,009</b>	<b>16,860</b>	<b>74,046</b>	-11%	-12%	-2%
Operating cost	-16,548	-15,875	-17,256	-17,250	-66,929	-16,450	-17,704	-16,528	-14,808	-65,490	-10%	-14%	-2%
Tax & surcharges	-108	-14	-39	-33	-194	-25	-50	-43	-95	-213	121%	188%	10%
<b>Operating profit</b>	<b>2,512</b>	<b>1,865</b>	<b>1,943</b>	<b>1,886</b>	<b>8,206</b>	<b>1,924</b>	<b>2,024</b>	<b>2,438</b>	<b>1,957</b>	<b>8,343</b>	-20%	4%	2%
Operating expenses	-366	-424	-470	-483	-1,743	-506	-528	-600	-584	-2,218	-3%	21%	27%
Admin expenses	-919	-825	-851	-675	-3,270	-381	-450	-485	-534	-1,850	10%	-21%	-43%
Financial expenses	-403	-304	-235	-276	-1,218	-318	-361	-314	-279	-1,272	-11%	1%	4%
Asset impairment loss	-462	-380	-456	-568	-1,866	-551	-484	-535	-541	-2,111	1%	-5%	13%
<b>Sub-total SG &amp; A</b>	<b>-2,150</b>	<b>-1,933</b>	<b>-2,012</b>	<b>-2,002</b>	<b>-8,097</b>	<b>-1,756</b>	<b>-1,823</b>	<b>-1,934</b>	<b>-1,938</b>	<b>-7,451</b>	0%	-3%	-8%
<b>Net profit</b>	<b>362</b>	<b>-68</b>	<b>-69</b>	<b>-116</b>	<b>109</b>	<b>168</b>	<b>201</b>	<b>504</b>	<b>19</b>	<b>892</b>	-96%	nm	718%
Investment income	157	127	125	146	555	157	248	146	122	673	-16%	-16%	21%
Non-OP income	8	66	33	51	158	60	21	29	51	161	76%	0%	2%
Non-OP expenses	-8	-12	-20	-54	-94	-9	-28	-86	-24	-147	-72%	-56%	56%
<b>Profit before tax</b>	<b>519</b>	<b>113</b>	<b>69</b>	<b>27</b>	<b>728</b>	<b>376</b>	<b>442</b>	<b>593</b>	<b>168</b>	<b>1,579</b>	-72%	522%	117%
Tax	7	49	-7	-22	27	-90	-151	-248	-166	-655	-33%	655%	nm
MI	14	0	1	0	15	0	0	1	3	4	200%	nm	-73%
<b>Profit after tax</b>	<b>540</b>	<b>162</b>	<b>63</b>	<b>5</b>	<b>770</b>	<b>286</b>	<b>291</b>	<b>346</b>	<b>5</b>	<b>928</b>	<b>-99%</b>	<b>0%</b>	<b>21%</b>
Exceptional items	27	40	10	-2	75	38	-5	-43	21	11	nm	nm	-85%
<b>Core Net Profit</b>	<b>513</b>	<b>122</b>	<b>53</b>	<b>7</b>	<b>695</b>	<b>248</b>	<b>296</b>	<b>389</b>	<b>-16</b>	<b>917</b>	<b>nm</b>	<b>nm</b>	<b>32%</b>
EPS (Rmb)	0.075	0.022	0.009	0.001	0.106	0.040	0.040	0.048	0.001	0.128	-99%	0%	21%
DPS (Rmb)					0.03					0.05			67%
<b>Cash flow</b>													
Operating CF	5,487	5,176	1,074	-1,174	10,563	1,045	340	832	-80	2,137	nm	-93%	-80%
Investment CF	-872	1,033	-872	-1,879	-2,590	-577	-801	-1,407	-1,640	-4,425	17%	-13%	71%
Capex	-637	-461	-930	-920	-2,948	-611	-812	-1,287	-1,706	-4,416	33%	85%	50%
FCF	4,850	4,715	144	-2,094	7,615	434	-472	-455	-1,786	-2,279	293%	-15%	nm

<b>P&amp;L ratio</b>													
Operating profit	13.1%	10.5%	10.1%	9.8%	10.9%	10.5%	10.2%	12.8%	11.6%	11.3%	-1pps	2pps	0pps
Net profit	1.9%	-0.4%	-0.4%	-0.6%	0.1%	0.9%	1.0%	2.7%	0.1%	1.2%	-3pps	1pps	1pps
Profit before tax	2.7%	0.6%	0.4%	0.1%	1.0%	2.0%	2.2%	3.1%	1.0%	2.1%	-2pps	1pps	1pps
Profit after tax	2.8%	0.9%	0.3%	0.0%	1.0%	1.6%	1.5%	1.8%	0.0%	1.3%	-2pps	0pps	0pps
Tax rate	-1.3%	-43%	10.1%	81.5%	-3.7%	23.9%	34.2%	41.8%	98.8%	41.5%	57pps	17pps	45pps
Dividend payout					25%					35%			10pps
<b>Per tonne analysis</b>													
Sales volume (kt)	4,794	4,334	4,922	4,968	19,018	5,011	5,011	4,984	4,984	19,990	0%	0%	5%
Revenue/t(Rmb/t)	3,998	4,096	3,909	3,858	3,961	3,672	3,947	3,814	3,383	3,704	-11%	-12%	-6%
COGS/t (Rmb/t)	3,452	3,663	3,506	3,472	3,519	3,283	3,533	3,316	2,971	3,276	-10%	-14%	-7%
GP/t (Rmb/t)	524	430	395	380	431	384	404	489	393	417	-20%	3%	-3%
Core GP/t	107	28	11	1	37	49	59	78	-3	46	nm	nm	26%
<b>Ratios</b>													
Net Debt/Equity	40%	36%	37%	35%	35%	34%	37%	37%	42%	42%	4pps	7pps	7pps
Current Ratio	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.7	-7%	-7%	-7%
Quick Ratio	0.4	0.4	0.5	0.4	0.4	0.5	0.4	0.5	0.4	0.4	-6%	-4%	-4%
Invt T/O Days	59	64	59	65	67	73	63	66	67	61	2%	2%	-10%
A/R T/O days	54	45	63	61	62	51	49	45	57	51	26%	-7%	-17%
A/P T/O days	52	65	77	81	84	77	57	54	53	48	-2%	-35%	-43%
Conversion Days	61	44	45	45	45	47	55	57	70	64	24%	57%	41%
ROA	2%	1%	0%	0%	1%	1%	1%	1%	0%	1%	-1pps	0pps	0pps
ROE	5%	1%	1%	0%	2%	2%	2%	3%	0%	2%	-3pps	0pps	0pps

Source: Company reports, J.P. Morgan

## Investment Thesis

Angang is a leading steel maker in China, with 90% of the product mix geared toward flat steels. Angang's share price is near our PT of HK\$6 (based on 0.7x P/B) following the rally from last May's lows and at a 0.7x P/B, close to the high end of its historical three-year trading range (0.4-0.8x P/B). We view Angang as fairly valued and stay Neutral.

## Valuation

Our Dec-15 price target for Angang-H is HK\$6.00, based a 0.7x P/B and our 2015E book value of Rmb6.7/share. We arrive at a target P/B of 0.7x using a blend of three-year average P/B of 0.9x and the implied P/B of 0.6x derived from our residual income model ( $P/B = ROE-g/COE-g$ ) using our forecast 2014-16E ROE.

## Risks to Rating and Price Target

Upside risks include production controls on cuts to overcapacity and pollution, higher-than-expected product prices, lower-than-expected cost pressure, and industry M&A activities. Downside risks include lower-than-expected product prices, higher-than-expected cost pressure, and potential asset injections following parent-level consolidation activities.

Steel

AC

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
13-Aug-08	OW	10.30	16.00
24-Oct-08	OW	3.56	9.50
11-Nov-08	OW	6.14	9.40
05-Mar-09	UW	6.83	5.20
09-Jun-09	N	12.86	13.80
31-Jul-09	OW	17.58	19.10
28-Oct-09	OW	16.16	18.00
22-Jan-10	UW	14.68	12.00
10-Aug-10	N	11.94	12.00
12-Oct-10	OW	13.32	15.95
31-Oct-10	OW	12.54	14.50
22-Mar-11	OW	10.38	--
06-Aug-11	UW	7.98	6.50
23-Aug-11	UW	6.01	5.50
30-Oct-11	N	4.95	5.50
28-Nov-11	N	4.44	4.50
20-Jan-12	N	6.63	7.00
17-Apr-12	N	5.31	6.20
08-Jul-12	N	4.49	5.50
30-Jul-12	OW	3.65	5.50
21-Nov-12	OW	4.58	6.00
31-Jan-13	N	6.06	6.00
01-Apr-13	OW	4.78	6.00
30-Oct-13	OW	4.49	5.50
23-Jan-14	N	5.23	5.50
15-Aug-14	N	5.79	6.00

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