

Company Report: **Xiwang Special Steel (01266 HK)**

Sean Xiang 向宇豪
(86755) 2397 6725
xiangyuhao@gtjas.com

公司报告: 西王特钢 (01266 HK)

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Gaming between Long and Short Process Steelmaking Forms Profit Ceiling in Medium-term, Downgrade to "Accumulate"

长短流程炼钢之间的博弈将在中期形成盈利天花板，下调至“收集”

- **FY17 results surged by 167.9%.** Revenue rose by 63.4% YoY with steel sales volume increased by 10.4% YoY, contributed by rising sales of ordinary steel products. GPM up 2.3 ppt YoY to 16.4% with GP/t recorded RMB647, up by 73.9% YoY. Net profit recorded RMB898 mn, up by 167.9% YoY.
- **Social inventory declines but inventory at mills is stacking up.** Recent social inventory declined while shipment volume from major steel mills climbed, underpinning active destocking is occurring. That said, dealers may become more cautious in restocking, resulting in higher inventory at mills. We think such trend will continue to catalyze on steel price risk if downstream demand could not alter dealers' expectations.
- **The game between long process and short process steelmaking could be the major obstacle for consistent price level jump.** EAF utilization should temporarily decline due to poor profitability, yet BF based steelmaking may simultaneously reduce steel scrap input, as production volume hedge is no longer needed. This has weighed down on steel scrap prices, which may again make EAF steel profitable and naturally form new supply again.
- **EAF resumption and flexibility in switch between iron water and steel scrap in long-process steelmaking forms earnings ceiling for steel industry in medium-term,** as both processes could hedge away the steel output cut driven by steel production restrictions and prevent mills from achieving supernormal profit consistently due to supply restrictions. Therefore, based on 0.6x FY18 PBR, we trim down Xiwang's TP to HK\$2.00 and simultaneously downgrade its investment rating to "Accumulate".
- **2017 财年净利润激增 167.9%。** 在钢材销量受到来自普钢产品销量上升的影响而同比提升 10.4% 的背景下，收入同比上升 63.4%。毛利率同比改善 2.3 个百分点至 16.4%，吨毛利录得人民币 647，同比提升 73.9%。净利录得人民币 8.98 亿，同比增 167.9%。
- **社会库存下滑但钢材库存正在堆积。** 近期在主要钢厂发货上扬的背景下社会库存出现下滑，表明主动去库存正在进行。然而，钢贸商可能对补库存更加谨慎，导致钢厂库存的上升。我们认为若下游需求不能改变钢贸商的预期，该趋势将继续催化钢铁的价格风险。
- **长流程和短流程炼钢的博弈可能将作为钢价持续走强的主要障碍。** 由于较弱的利润水平，电炉利用率暂时性地下滑。然而高炉炼钢也可能同时减少废钢掺入，源于已经不需要进行产量对冲。这将打压废钢的价格，并且再次使得电炉钢盈利从而自然地产生新的供给。
- **电炉复产以及长流程炼钢中铁水和废钢的灵活转换将在中期构成钢铁行业的盈利天花板，** 源于两种流程均可以对冲掉来自限产所导致的钢材产量下滑，从而防止钢厂因供应限制而持续性地获得超额盈利。因此，基于 0.6 倍的 2018 财年市净率，我们下调西王特钢的目标价至 2.00 港元，并且同时下调其投资评级至“收集”。

Rating:

Accumulate

Downgraded

评级:

收集 (下调)

6-18m TP 目标价:

HK\$2.00

Revised from 原目标价:

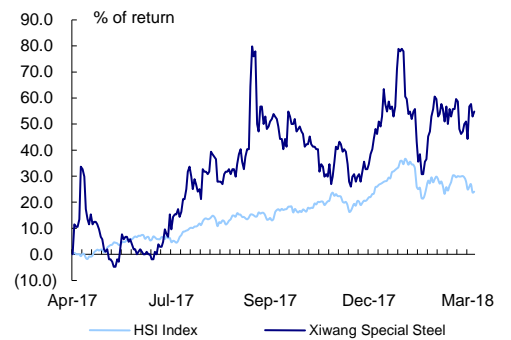
HK\$2.25

Share price 股价:

HK\$1.630

Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	0.6	7.2	56.7
Rel. % to HS Index 相对恒指变动 %	1.7	8.1	27.6
Avg. share price(HK\$) 平均股价 (港元)	1.6	1.6	1.4

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(Δ%)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2016A	7,567	333	0.166	96.5	8.8	2.001	0.7	0.000	0.0	8.5
2017A	12,362	898	0.443	167.9	3.0	2.305	0.6	0.133	10.1	19.6
2018F	13,111	1,063	0.504	18.3	2.6	2.661	0.5	0.151	11.4	19.2
2019F	14,337	1,233	0.584	16.0	2.3	3.070	0.4	0.175	13.3	19.3
2020F	15,502	1,310	0.621	6.2	2.1	3.491	0.4	0.186	14.1	17.9
Shares in issue (m) 总股数 (m)			2,262.4		Major shareholder 大股东		Xiwang Investment 69.7%			
Market cap. (HK\$ m) 市值 (HK\$ m)			3,687.7		Free float (%) 自由流通比率 (%)		30.3%			
3 month average vol. 3 个月平均成交股数 ('000)			15,608.3		FY18 Net gearing (%) FY18 净负债/股东资金 (%)		49.2			
52 Weeks high/low (HK\$) 52 周高/低			1.960 / 0.960		FY18 Est. NAV (HK\$) FY18 每股估值 (港元)		2.3			

Source: the Company, Guotai Junan International.

RESULTS REVIEW

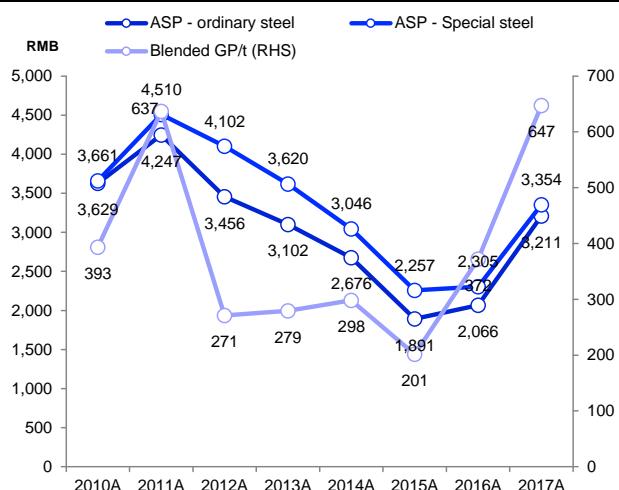
FY17 results surged by 167.9%. Xiwang's FY17 results were in-line with our forecasts. Revenue rose by 63.4% YoY, mainly attributed by steel price hikes during 2017. Steel sales volume rose by 10.4% YoY, mainly due to 15.7% YoY sales volume increase in ordinary steel while sales volume of special steel products declined by 3.3% YoY. Gross profit was up by 89.6% YoY with gross margin at 16.4%, up by 2.3 ppt YoY. Among which, GPM from ordinary steel improved by 2.4 ppt YoY to 21.2%, while GPM from special steel improved 1.8ppt YoY to 16.3%. GP/t for steel products recorded RMB647, up by 73.9% YoY. GP/t for ordinary steel improved from RMB387 in FY16 to RMB681 in FY17, up by 75.9% YoY while GP/t from special steel improved from RMB334 in FY16 to RMB546 in FY17, up by 63.5% YoY. Selling expenses were up by 4 times YoY, due to surging transportation costs from change in product delivery terms. G&A expenses rose by 87.3% YoY due to rising professional fees regarding share placements and financing. Subject to the new tax rate for High-tech enterprises, Xiwang's effective tax rate dropped by 3.4 ppt in FY17 to 18.6%. Net profit recorded RMB898mn, up by 167.9% YoY. Xiwang announced a final DPS of RMB0.13, representing dividend payout of ~30% in FY17.

Table-1: FY17 Results Review

	FY17	FY16	YoY	Comments
Major operating figures				
ASP - ordinary steel	3,185	2,034	56.6%	
ASP - special steel	3,265	2,150	51.9%	
Shipment volume - ordinary steel (kt)	2,328	2,012	15.7%	Volume increase from both rebar and wire rods
Shipment volume - special steel	760	785	-3.3%	Volume drop in quality carbon structure steel, more capacity has been utilized for ordinary steel production
Blended GP/t	647	372	73.9%	Steel price hikes & lower costs for iron ore
Financial results (RMB Mn)				
Revenue	12,362	7,567	63.4%	
COGS	(10,337)	(6,498)	59.1%	
Gross profit	2,025	1,068	89.6%	
Other income and gains	30	22	34.2%	
Selling and distribution expenses	(103)	(21)	399.9%	Changes in distribution term, more transportation costs are incurred
Administrative expenses	(98)	(52)	87.3%	Professional fees for financing
Other expenses	(51)	(2)	2749.2%	Impairment losses & losses from disposal of PP&E etc.
Research and development costs	(371)	(253)	46.5%	
Operating profit	1,103	427	158.7%	
Finance costs	(329)	(336)	-2.2%	Higher capitalized interest costs
Profit before tax	1,103	427	158.7%	
Income tax expense	(205)	(94)	118.5%	Lower effective tax rate due to new tax rate applied to high-tech subsidiary
Shareholders' profit	898	333	167.9%	
EPS	0.442	0.166	166.4%	
Margins & Ratios				
Gross profit margin	16.4%	14.1%	2.3ppt	
Operating margin	8.9%	10.1%	-1.2ppt	
PBT margin	8.9%	5.6%	3.3ppt	
Net margin	7.3%	4.4%	2.9ppt	
Net gearing	71.3%	120.0%	-48.6ppt	Lower interest bearing debts as the Company had repaid debts from ultimate holding company

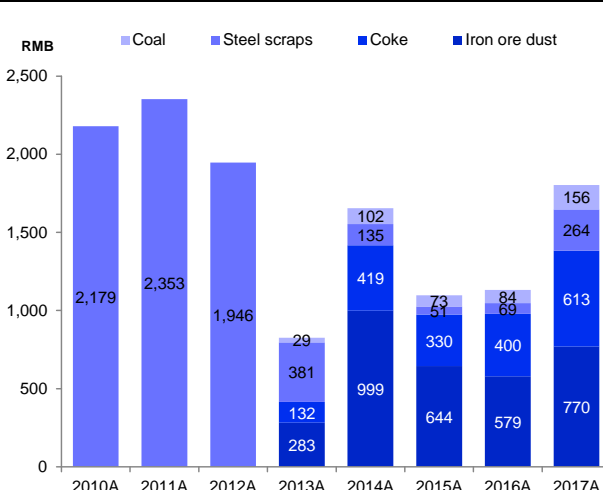
Source: the Company, Guotai Junan International.

Figure- 1: ASP and GP/t for Steel Products



Source: the Company, Guotai Junan International.

Figure- 2: Implied Major Costs for Steel Products

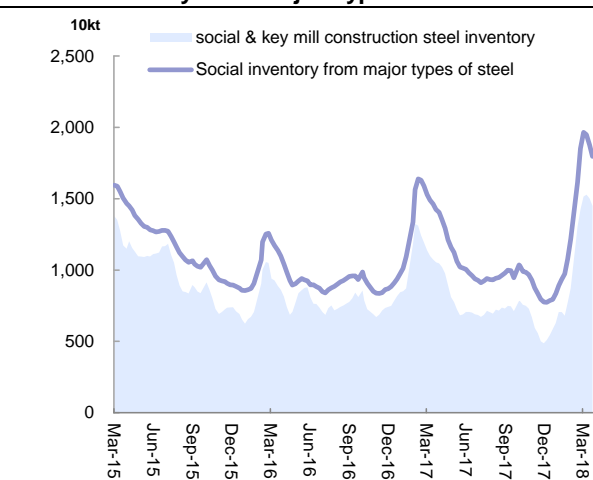


Source: the Company, Guotai Junan International.

KEY UPDATES

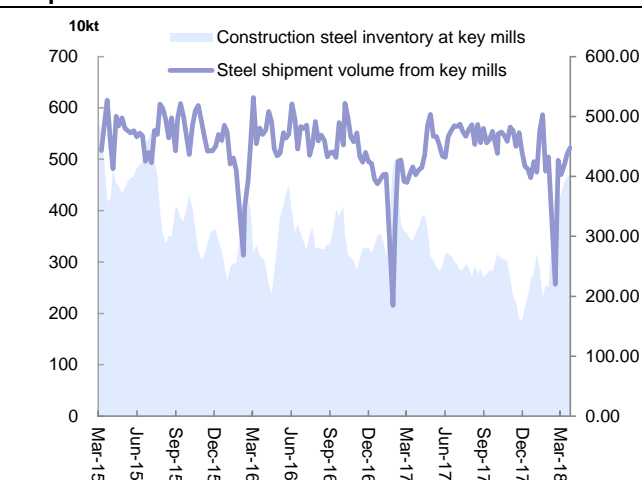
Social inventory destock initiated but inventory at mills is stacking up; inventory risk has not been released yet. While steel inventory had been stacked up owing to upbeat post Chinese New Year downstream expectations and rising speculations demand during Jan. to Feb. 2018, domestic steel prices have been weighed down substantially during Mar. triggered by slower-than-expected demand recovery, as speculators started to unwind their position due to financial pressure and in protection from further loss-making. In recent two weeks, we observe strong demand pick up, with social inventory started to decline while shipment volume from major steel mills climbed still, underpinning active destocking is undergoing. This can also be cross-checked by cement shipment volume as well, where we observe downstream procurement in eastern and central China initiated starting from late Mar. We think inventory risk has not yet be desorbed, as steel dealers may become more cautious in inventory management, resulting in higher inventory at mills if downstream demand could not alter dealer's expectations.

Figure- 3: Social & Key Mills Construction Inventory and Social Inventory from Major Types of Steel



Source: Mysteel, Guotai Junan International.

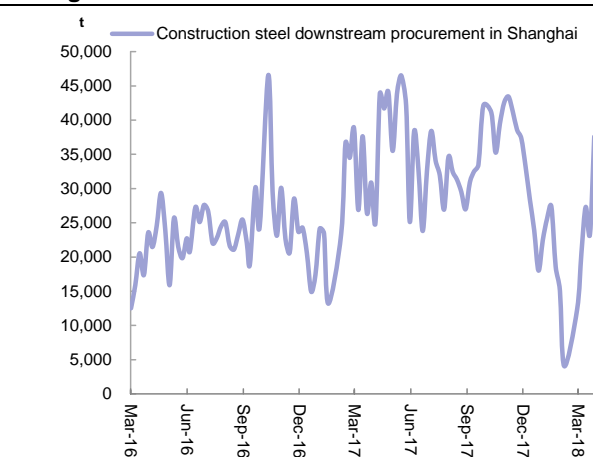
Figure- 4: Construction Steel Inventory at Key Mills and Shipment Volume



Source: Mysteel, Guotai Junan International.

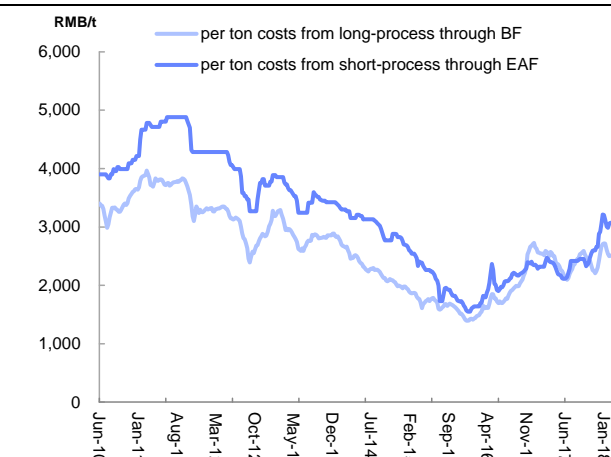
EAF utilization should temporarily decline amid loss-making conditions but still form the major supply risk. We estimate cost of steel from short process is loss making at the moment with cost to be ~RMB600/t higher than it from long process, making EAF steel uncompetitive in profitability and should lead a temporary supply decline from EAF. However, followed by the production resumption, BF based steel will start to reduce their steel scrap input, as production volume hedge is no longer needed. This has reflected to steel scrap prices very soon, as we observe ~10% price decline in a single week, which may again make EAF steel profitable and naturally forming new supply again. In our view, if downstream could not beat expectations, the game between profit from long process and short process steelmaking could be the major obstacle for durative price level jump.

Figure- 5: Construction Steel Downstream Procurement in Shanghai



Source: Xiben, Guotai Junan International.

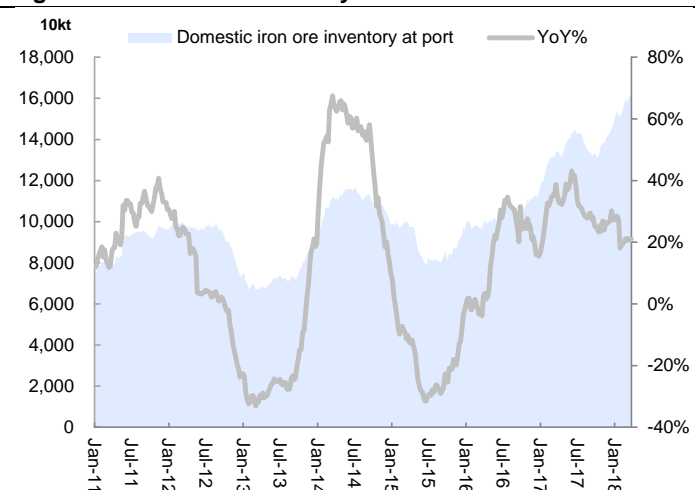
Figure- 6: Cross Region Cement Prices in China (2018)



Source: Guotai Junan International.

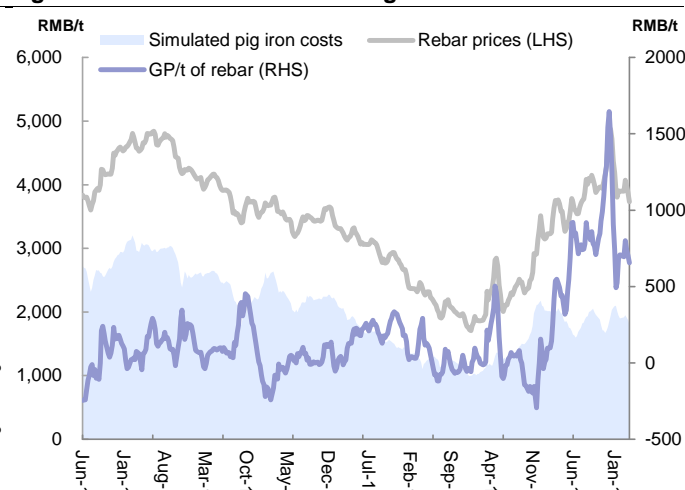
Iron ore at ports is still accumulating, being the key support to a moderate GP/t for mills. Currently iron ore at port amounted to 162.8mn tons, up by 21% YoY. While approximately 46mn tons iron ore volume add is expected in 2018 from key iron ore suppliers, we believe iron ore price rebound continue to be restricted by the enormous amount inventory at port. Therefore, we see costs of BF process steelmaking to be stabilized in medium-term, GP/t for major types of steel products will be largely shaped by demand elasticity at least in Q2 and Q3 in 2018.

Figure- 7: Iron Ore Inventory at Ports



Source: Mysteel, Guotai Junan International.

Figure- 8: GP/t for BF steelmaking



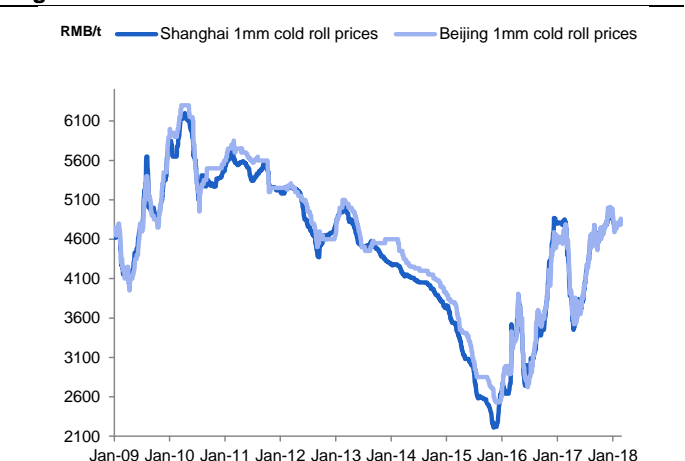
Source: Mysteel, Guotai Junan International.

Figure- 9: Domestic Hot Roll Prices



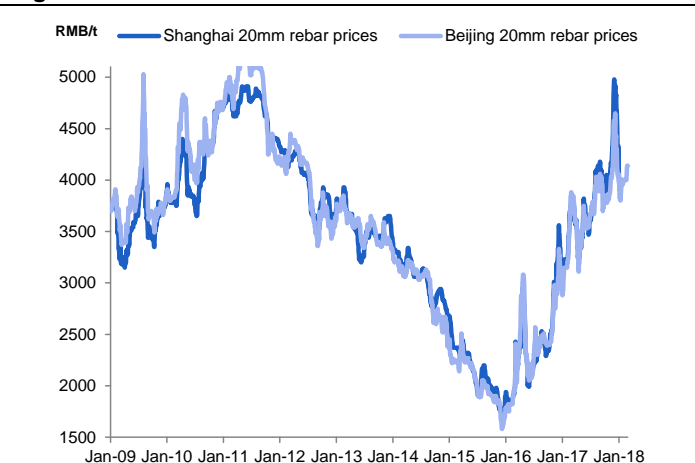
Source: Mysteel, Guotai Junan International.

Figure- 10: Domestic Cold Roll Prices



Source: Mysteel, Guotai Junan International.

Figure- 11: Domestic Rebar Prices



Source: Mysteel, Guotai Junan International.

Figure- 12: Domestic Medium Plate Prices



Source: Mysteel, Guotai Junan International.

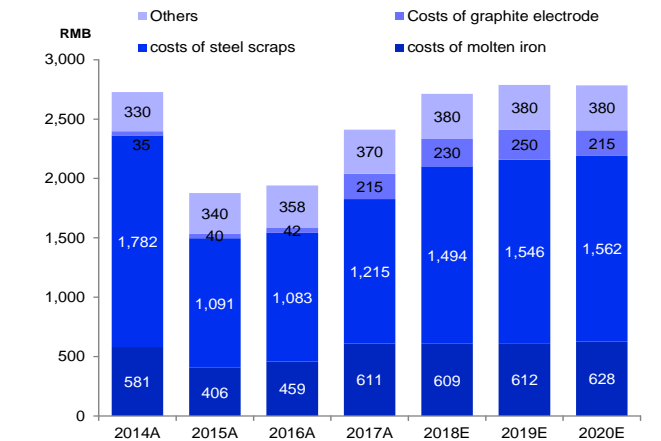
EARNINGS REVISION

We made the following adjustment to Xiwang's earnings assumptions based on recent industry fundamentals:

- Slightly raise steel ASP forecasts for 2018/2019.** Despite steel prices declined substantially post the CNY, average steel price level in 1Q18 is still approx. 3.5% higher than the price level in 1Q17. We expect steel price to rally in Apr given the kick-start of active destocking, but the consistency of this price rebound will be dependent on the effectiveness of destocking and EAF resumption. Special steel ASP cut is due to consideration of slower commercialization of the Company's rail steel products.
- Raising coke/steel scrap price forecasts.** We expect coke prices to maintain at a fairly high level due to environmental measures. Steel scrap prices are largely affected by the utilization of EAF, as well as consumption from long-process steel making. Currently we see demand for steel scrap being seasonally supported by increased consumption from long-process steelmaking, in a bid to hedge away the volume cut from production restrictions. This should weigh down on GP/t of special steel products, as they are usually manufactured through EAF.
- Raise other income and gains,** due to expectations of higher government subsidy received by Xiwang.
- Trim down finance costs,** owing to lower outstanding borrowings.
- Cut down effective tax rate from FY18,** due to new tax rate being applied for high-tech enterprises.

Figure-13: Simulated Raw Material Cost for Steel Billets Through BF (Long-process) Steel Production for the Company

Figure-14: Simulated Costs for Steel Billets Through EAF (Short-process) Steel Production for the Company

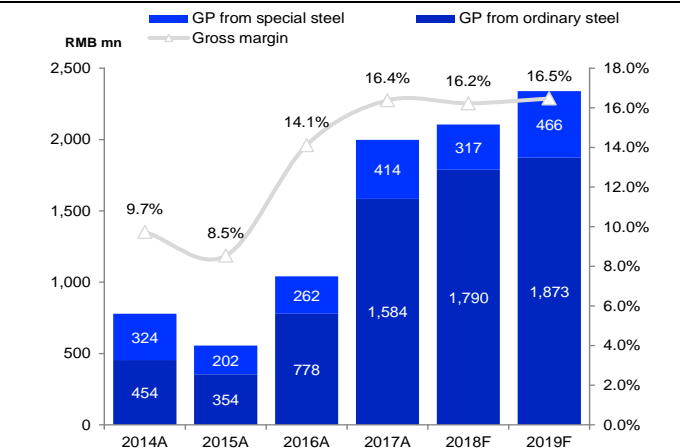
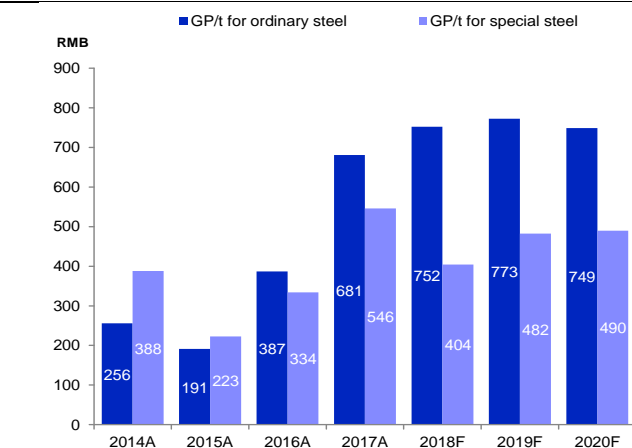


Source: Guotai Junan International.

Source: Guotai Junan International.

Figure- 15: National Cement Prices from Different Regions

Figure- 16: Cement-coal Price Gap from CRC's Operating Regions



Source: the Company, Guotai Junan International.

Source: the Company, Guotai Junan International.

Table-2: Key Earnings Assumptions

	Old Forecast			New Forecast			Revision		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
Operations									
ASP - ordinary steel	3,259	3,324	n.a.	3,348	3,398	3,431	2.7%	2.2%	n.a.
ASP - special steel	3,459	3,840	n.a.	3,488	3,695	3,760	0.8%	-3.8%	n.a.
Shipment volume - ordinary steel (kt)	2,241	2,284	n.a.	2,380	2,425	2,450	6.2%	6.2%	n.a.
Shipment volume - special steel	836	1,095	n.a.	784	966	1,182	-6.2%	-11.7%	n.a.
Raw material costs									
Iron ore dust	453	444	n.a.	453	444	457	0.0%	0.0%	n.a.
Coke	1,658	1,740	n.a.	1,688	1,738	1,791	1.8%	-0.1%	n.a.
Steel scraps	1,689	1,757	n.a.	1,889	1,955	1,974	11.8%	11.3%	n.a.
Coal	547	558	n.a.	547	558	569	0.0%	0.0%	n.a.
GP/t - ordinary steel	771	793	n.a.	752	773	749	-2.5%	-2.5%	n.a.
GP/t - special steel	479	716	n.a.	404	482	490	-15.5%	-32.6%	n.a.
Blended GP/t	692	768	n.a.	666	690	665	-3.8%	-10.1%	n.a.
Financials (RMB Mn)									
Revenue	12,603	14,323	n.a.	13,111	14,337	15,502	4.0%	0.1%	n.a.
Gross profit	2,150	2,616	n.a.	2,128	2,362	2,437	-1.0%	-9.7%	n.a.
Other income and gains	53	109	n.a.	68	118	193	27.2%	8.8%	n.a.
Selling and distribution expenses	(101)	(115)	n.a.	(105)	(115)	(124)	4.0%	0.1%	n.a.
Administrative expenses	(55)	(58)	n.a.	(53)	(54)	(57)	-4.5%	-5.4%	n.a.
Other expenses	(11)	(10)	n.a.	(48)	(45)	(42)	332.8%	332.8%	n.a.
Research and development costs	(269)	(274)	n.a.	(464)	(534)	(614)	72.7%	94.7%	n.a.
Operating profit	1,768	2,268	n.a.	1,526	1,732	1,793	-13.7%	-23.6%	n.a.
Finance costs	(357)	(328)	n.a.	(231)	(215)	(187)	-35.3%	-34.2%	n.a.
Profit before tax	1,411	1,940	n.a.	1,295	1,516	1,606	-8.2%	-21.8%	n.a.
Net profit	1,037	1,413	n.a.	1,063	1,233	1,310	2.5%	-12.8%	n.a.
EPS (RMB)	0.492	0.670	n.a.	0.504	0.584	0.621	2.5%	-12.8%	n.a.
BPS	2.750	3.273	n.a.	2.661	3.070	3.491	-3.3%	-6.2%	n.a.
Margins and ratios									
Revenue growth	5.6%	13.6%	n.a.	6.1%	9.4%	8.1%	0.5ppt	-4.3ppt	n.a.
Gross profit growth	12.7%	21.7%	n.a.	5.1%	11.0%	3.2%	-7.6ppt	-10.7ppt	n.a.
Net profit growth	22.7%	36.3%	n.a.	18.3%	16.0%	6.2%	-4.4ppt	-20.3ppt	n.a.
Gross margin	17.1%	18.3%	n.a.	16.2%	16.5%	15.7%	-0.8ppt	-1.8ppt	n.a.
Net Profit Margin	8.2%	9.9%	n.a.	8.1%	8.6%	8.4%	-0.1ppt	-1.3ppt	n.a.
ROE	19.2%	22.2%	n.a.	19.2%	19.3%	17.9%	0.0ppt	-3.0ppt	n.a.

Source: Guotai Junan International.

Table-3: Sensitivity Analysis on FY18 EPS from Changes in the Company's Rebar ASP and Shipment Volume

% change of EPS (RMB)	Changes in the Company's rebar prices									
	-15%	-10%	-5%	-3%	0%	3%	5%	10%	15%	
changes in rebar sales volume	-15%	-125%	-88%	-51%	-37%	-15%	7%	22%	59%	96%
	-10%	-123%	-85%	-48%	-32%	-10%	13%	28%	66%	104%
	-5%	-121%	-83%	-44%	-28%	-5%	18%	34%	73%	112%
	-3%	-121%	-81%	-42%	-26%	-3%	21%	36%	76%	115%
	0%	-120%	-80%	-40%	-24%	0%	24%	40%	80%	120%
	3%	-119%	-78%	-38%	-21%	3%	27%	43%	84%	124%
	5%	-118%	-77%	-36%	-20%	5%	29%	46%	87%	128%
	10%	-116%	-74%	-32%	-15%	10%	35%	52%	94%	136%
	15%	-114%	-71%	-28%	-11%	15%	40%	58%	101%	143%

Source: Guotai Junan International.

Table-4: Sensitivity Analysis FY18 EPS from Changes in Iron Ore Prices and Coke Prices

% change of EPS (RMB)	Changes in iron ore prices									
	-15%	-10%	-5%	-3%	0%	3%	5%	10%	15%	
changes in iron ore prices	-15%	57%	48%	40%	36%	31%	25%	22%	13%	4%
	-10%	47%	38%	29%	26%	20%	15%	12%	3%	-6%
	-5%	37%	28%	19%	16%	10%	5%	1%	-7%	-16%
	-3%	33%	24%	15%	11%	6%	1%	-3%	-11%	-20%
	0%	26%	18%	9%	5%	0%	-5%	-9%	-18%	-26%
	3%	20%	11%	3%	-1%	-6%	-11%	-15%	-24%	-33%
	5%	16%	7%	-1%	-5%	-10%	-16%	-19%	-28%	-37%
	10%	6%	-3%	-12%	-15%	-20%	-26%	-29%	-38%	-47%
	15%	-4%	-13%	-22%	-25%	-31%	-36%	-40%	-48%	-57%

Source: Guotai Junan International.

VALUATION

Mutual restriction from profitability and volume forms earnings ceiling, downgrade to "Accumulate". We believe profit ceiling in steel industry is formed with EAF resumption and the flexibility in switched between iron water and steel scrap in long-process steelmaking, as both ways could hedge away the crude steel output cut caused by production restrictions from environment measures, which makes steel enterprise hardly to achieve consistent supernormal profit. While steel prices could hardly being raised to another higher level subject to the S-D condition in short-to-medium term, the potential turnaround in iron ore prices set a major risk for mills' earnings in medium term. Therefore, despite expectations in higher earnings in FY18, we start to see more risks surface that could potential destroy the current high profitability condition, among which the 2H18 downstream demand remains the biggest uncertainty. Therefore, based on 0.6x FY18 PBR, we cut Xiwang's TP to HK\$2.00 and simultaneously downgrade its investment rating to "Accumulate".

Table-5: Peers Comparison

Company	Stock Code	Currency	Last price	PE (fiscal year)				PB (fiscal year)				ROE(%)	GP Margin(%)	Dividend Yield (%)	Market Cap
				17A	18F	19F	20F	17A	18F	19F	20F	18F	18F	18F	HKD mil
HK Listed Steel Manufacturers															
Xiwang Special Steel Co Ltd	1266 HK	HKD	1.63	3.2	2.6	2.1	n.a.	0.6	0.4	0.3	n.a.	20.3	17.2	8.7	3,688
China Oriental Group Co Ltd	581 HK	HKD	5.32	3.3	4.1	3.8	n.a.	1.2	n.a.	n.a.	n.a.	n.a.	n.a.	9.0	19,804
Maanshan Iron & Steel-H	323 HK	HKD	3.45	5.6	4.9	4.9	5.9	0.9	0.8	0.7	0.6	16.8	13.8	4.2	31,986
Angang Steel Co Ltd-H	347 HK	HKD	7.47	8.3	7.3	7.4	7.3	0.9	0.8	0.7	0.7	11.1	15.1	3.9	53,336
Simple Average				5.1	4.7	4.6	6.6	0.9	0.7	0.6	0.6	16.0	15.3	6.5	
Weighted Average				6.4	5.9	5.8	5.3	0.9	0.6	0.6	0.5	11.0	12.0	5.1	
Mainland Listed Steel Manufacturers															
Angang Steel Co Ltd-A	000898 CH	CNY	5.89	7.6	7.6	7.6	7.0	0.9	0.8	0.7	0.7	10.5	14.4	4.1	53,336
Hunan Valin Steel Co Ltd -A	000932 CH	CNY	7.65	5.6	5.0	4.7	4.0	2.2	1.6	1.2	0.9	31.2	13.7	6.1	28,807
Beijing Shougang Co Ltd-A	000959 CH	CNY	4.72	11.3	9.3	9.0	8.9	0.9	1.0	0.9	0.9	9.8	18.6	n.a.	31,175
Inner Mongolia Baotou Ste-A	600010 CH	CNY	2.17	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	123,521
Baoshan Iron & Steel Co-A	600019 CH	CNY	8.37	10.1	9.0	8.1	n.a.	1.2	1.1	1.0	n.a.	12.7	13.3	6.0	232,736
Lingyuan Iron & Steel Co-A	600231 CH	CNY	3.83	7.1	6.3	5.7	n.a.	1.4	1.2	1.0	n.a.	19.2	14.6	3.9	12,048
Xinyu Iron & Steel Co Ltd-A	600782 CH	CNY	5.75	5.3	5.9	5.2	4.7	1.4	1.2	1.0	0.7	22.2	12.8	3.1	22,895
Sgis Songshan Co Ltd-A	000717 CH	CNY	5.97	5.7	5.7	5.3	n.a.	4.9	2.9	1.9	n.a.	52.4	18.2	n.a.	18,037
Simple Average				7.5	7.0	6.5	6.1	1.8	1.4	1.1	0.8	22.6	15.1	4.6	
Weighted Average				6.9	6.2	5.7	1.7	1.1	0.9	0.8	0.2	12.3	10.8	3.6	
Global Listed Steel Manufacturers															
Arcelormittal	MT NA	EUR	25.42	6.4	8.1	8.4	8.4	0.8	0.8	0.7	0.7	10.0	12.0	1.6	251,274
Nucor Corp	NUE US	USD	59.85	14.6	10.6	10.7	11.3	2.2	1.9	1.7	1.5	19.0	14.3	2.5	149,361
United States Steel Corp	X US	USD	34.22	15.5	6.6	6.6	7.8	1.8	1.4	1.1	1.0	25.7	14.7	0.6	47,323
Nippon Steel & Sumitomo Meta	5401 JP	JPY	2,324.50	15.7	10.8	9.4	8.7	0.7	0.7	0.7	0.6	6.6	12.6	3.0	163,329
Posco	005490 KS	KRW	325,000.00	9.4	8.4	7.9	7.4	0.6	0.6	0.5	0.5	7.1	14.2	2.5	210,678
Tata Steel Ltd	TATA IN	INR	579.40	n.a.	9.3	7.9	7.4	1.6	1.4	1.2	1.1	16.0	53.2	1.6	80,152
Simple Average				12.3	9.0	8.5	8.5	1.3	1.1	1.0	0.9	14.0	20.2	2.0	
Weighted Average				10.1	9.1	8.7	8.6	1.1	1.0	0.9	0.8	11.5	16.8	2.2	

Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement					
Year end 31 Dec (RMB\$ m)	2016A	2017A	2018F	2019F	2020F
Total revenue	7,567	12,362	13,111	14,337	15,502
Cost of sales	(6,498)	(10,337)	(10,983)	(11,976)	(13,065)
Gross profit	1,068	2,025	2,128	2,362	2,437
Other income and gains	22	30	68	118	193
Selling and distribution expenses	(21)	(103)	(105)	(115)	(124)
Administrative expenses	(52)	(98)	(53)	(54)	(57)
Other expenses	(2)	(51)	(48)	(45)	(42)
R&D expenses	(253)	(371)	(464)	(534)	(614)
Operating Profit	763	1,432	1,526	1,732	1,793
Finance costs	(336)	(329)	(231)	(215)	(187)
Profit Before Tax	427	1,103	1,295	1,516	1,606
Income Tax	(94)	(205)	(233)	(284)	(296)
Profit After Tax	333	898	1,063	1,233	1,310
Shareholders' Profit / Loss	333	898	1,063	1,233	1,310
Basic EPS	0.166	0.443	0.504	0.584	0.621

Cash Flow Statement					
Year end 31 Dec (RMB\$ m)	2016A	2017F	2018F	2019F	2020F
CFO					
Profit before tax:	427	1,103	1,295	1,516	1,606
Adjustments for:					
Finance costs	336	329	231	215	187
Interest income	(7)	(8)	(50)	(106)	(181)
Depreciation	347	341	350	361	378
Others	(4)	2	2	2	2
Operating CF before WC changes	1,099	1,767	1,827	1,989	1,992
Changes in inventories	(385)	253	(101)	(84)	(80)
Changes in receivables	(78)	(123)	(62)	(45)	(45)
Changes in payables	209	516	176	204	226
Others	0	0	0	0	0
Cash generated from operations	845	2,413	1,840	2,064	2,094
Interest received	6	8	50	106	181
Interest element of finance lease	0	0	0	0	0
Government grant received	1	0	0	0	0
PRC tax paid	(39)	(192)	(228)	(267)	(282)
Cash from Operating Activities	812	2,230	1,663	1,903	1,992
CFI					
Purchases of items of PP&E	(578)	(633)	(569)	(797)	(957)
Decrease in pledged time deposits	128	(179)	(43)	27	121
Purchase of available-for-sale investment	0	0	0	0	0
Other investing activities	4	0	0	0	0
Cash from Investing Activities	(446)	(812)	(613)	(770)	(836)
CFF					
net changes in amount due to third parties	3,552	1,535	4,512	2,630	2,158
net changes in borrowings from ultimate holding company	(463)	(2,878)	0	0	0
Repayment of bank and other borrowings	(3,266)	(108)	(3,500)	(3,200)	(3,200)
Dividends paid	0	0	(269)	(319)	(370)
Issuance of convertible bonds	0	234	0	0	0
Interest paid	(344)	(329)	(231)	(215)	(187)
Other financing activities	0	151	(0)	0	0
Cash from Financing Activities	(522)	(1,395)	512	(1,104)	(1,599)
Net Changes in Cash	(156)	23	1,562	28	(442)
Cash at Beg of Year	272	102	126	1,687	1,716
Foreign exchange rate changes	(14)	0	0	0	0
Cash at End of Year	102	126	1,687	1,716	1,273

Source: the Company, Guotai Junan International.

Balance Sheet					
Year end 31 Dec (RMB\$ m)	2016A	2017A	2018F	2019F	2020F
Property, plant and equipment	9,718	10,207	10,426	10,863	11,441
Prepaid land lease payments	96	94	92	90	88
Available-for-sale investment	100	100	100	100	100
Deferred asset	0	0	0	0	0
Deferred tax assets	5	16	18	16	14
Total Non-current Assets	10,128	10,797	11,017	11,449	12,024
Cash & Cash Equivalents	102	126	1,687	1,716	1,273
Inventories	1,051	797	898	982	1,062
Trade and bills receivables	129	241	251	275	297
Prepayments, deposits and other receivables	182	193	245	266	289
Due from a fellow subsidiary	0	0	0	0	0
Derivative financial instruments	4	0	0	0	0
Income tax recoverable	0	0	0	0	0
Pledged deposits	335	514	557	530	410
Total Current Assets	1,802	1,871	3,639	3,769	3,331
Total Assets	11,930	12,668	14,655	15,218	15,355
Trade and bills payables	1,661	1,772	1,956	2,133	2,327
Receipts in advance, other payables and accruals	800	1,205	1,197	1,224	1,256
Interest-bearing bank and other borrowings	2,380	2,380	3,613	3,214	2,485
Borrowings from the ultimate holding company	1,482	0	0	0	0
Income tax payable	19	11	23	37	52
Other current liabilities	1	44	44	44	44
Total Current Liabilities	6,343	5,412	6,833	6,652	6,164
Interest-bearing bank and other borrowings	0	1,769	1,548	1,377	1,065
Due to the ultimate holding company	0	0	0	0	0
Borrowings from the ultimate holding company	1,400	4	4	4	4
Deferred tax liabilities	4	18	13	14	12
Other long term payable	161	161	161	161	161
Derivative financial instrument	0	0	0	0	0
Total Non-current Liabilities	1,565	2,110	1,884	1,714	1,399
Total Liabilities	7,908	7,522	8,716	8,365	7,562
Total Shareholders' Equity	4,022	5,146	5,939	6,853	7,793
Total Equity	4,022	5,146	5,939	6,853	7,793

Financial Ratios					
	2016A	2017A	2018F	2019F	2020F
Growth (%):					
Revenue	12.1	63.4	6.1	9.4	8.1
Gross profit	85.4	89.6	5.1	11.0	3.2
Operating profit	169.6	87.8	6.6	13.5	3.5
Net profit	96.5	167.9	18.3	16.0	6.2
Profitability (%):					
Gross margin	14.1	16.4	16.2	16.5	15.7
Operating margin	10.1	11.6	11.6	12.1	11.6
Net margin	4.4	7.3	8.1	8.6	8.4
ROA	2.8	7.3	7.8	8.3	8.6
ROE	8.3	19.6	19.2	19.3	17.9
Liquidity & Solvency					
Current Ratio (x)	0.3	0.3	0.5	0.6	0.5
Net gearing (%)	120.0	71.3	49.2	34.3	24.0
Interest coverage (x)	25.1	40.9	43.3	48.4	50.2
Dividend payout ratio (%)	-	30.0	30.0	30.0	30.0

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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 27/F., Low Block, Grand Millennium Plaza, 181 Queen's Road Central, Hong Kong.
 Tel.: (852) 2509-9118 Fax: (852) 2509-7793
 Website: www.gtja.com.hk