

Equity Research | China | Steel

20 April 2018

## 1Q18 results reaffirm solid growth intact

- Angang Steel's positive earnings growth in the first quarter, driven by higher steel prices and gross profit margins, reaffirms our view that the industry's earnings uptrend remains intact.
- In our view, the US steel tariffs will have a limited impact on the sector. Thus, we believe the outlook for China's steel industry would remain relatively stable amid the current supply-side industry reforms.
- Based on the management's guidance that the recent strong sales orders from shipbuilding and robust demand for rail steel products would continue through the second quarter, we have revised up our revenue and net profit estimates for FY18E by 14.0%/3.5% respectively. Our PT has also been revised up to HKD9.0 (from HKD8.5), based on 1.0x FY18E BVPS. Maintain Buy.

**1Q18 results reaffirm strong uptrend in earnings remains intact.** Net profit increased 48.8% YoY, driven by higher steel product prices and substantial margin expansion. Despite a traditional low season, the company has seen first quarter net profits at the highest level since 1Q08. Based on our calculation, the company's gross dollar margin has come in at RMB666/ton in the period, on a 10% YoY hike in its unit product selling prices and only a 6% increase in production cost.

**Market concern over U.S. tariffs on Chinese steel likely overdone.** As the price spread between steel products and raw materials has retreated from the Jan year-high level whilst the YTD average has remained higher than the full-year average in 2017, we believe the market is over concerned about the potential impact to be brought about by the U.S. steel tariffs given that the U.S. does not make up a significant portion of China's steel imports. According to China Customs data, China's total net export to steel products consumption ratio has decreased during the first three months of this year. As such, on assumption that downstream consumption would continue to grow in the coming quarter, we believe the impact from the trade tariffs would be relatively limited. Moreover, as the Chinese government has planned to shut down 30mn tons of obsolete capacity, we expect the demand-supply dynamics of the domestic steel industry to improve further amid the ongoing industry consolidation. According to official data, China's crude steel production has increased during first three months of 2018, whereas China's social steel inventory has resumed on a downtrend since mid-Mar, which signals an improving market, in our view.

**Appealing earnings recovery story.** We have revised up our FY18E earnings estimate on the back of management's latest guidance. Based on our forecast that Angang's ROE will recover to c.11.7% in 2018, which is significantly higher than only 5.5% in 2008, we have pegged our price target to our estimated per share book value. Accordingly, our PT has been raised to HKD9.0 (from HKD8.5), equivalent to 1.0x FY18E PBR, which we deem undemanding. Thus, maintain BUY.

## Angang Steel (347 HK)

**Buy**

(unchanged)

|                     |                |
|---------------------|----------------|
| <b>Price Target</b> | <b>HK\$9.0</b> |
| (Revision)          | (+5.8%)        |
| (upside)            | (8.6%)         |

|          |         |       |
|----------|---------|-------|
| EPS      | 2018E   | 2019E |
| revision | (+3.5%) | (N/A) |

|                |                |
|----------------|----------------|
| Close price    | HKD8.29        |
| Market cap.    | HKD57,690 mn   |
| Free float     | 15.0%          |
| 52-week range  | HKD4.76 – 9.45 |
| 3-mth ave. T/O | HKD165.6 mn    |

Price as of 19 April 2018

Stock rel HSI performance (%)



Duncan Chan

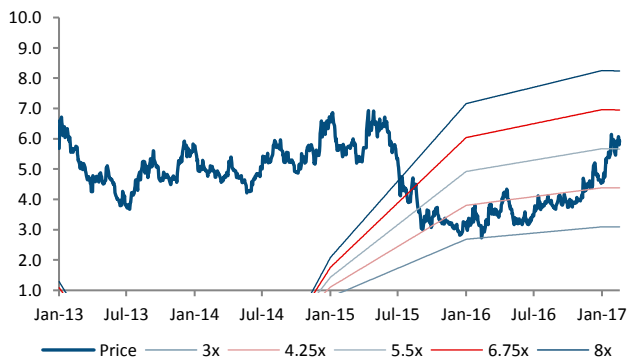
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**Figure 1: Angang's first quarterly results summary**

|                          | 1Q16    | 2Q16    | 3Q16    | 4Q16    | 1Q17   | 2Q17   | 3Q17    | 4Q17    | 1Q18   |
|--------------------------|---------|---------|---------|---------|--------|--------|---------|---------|--------|
| Unit: RMB mn             |         |         |         |         |        |        |         |         |        |
| Total revenue            | 11,220  | 14,071  | 15,538  | 16,782  | 19,187 | 19,476 | 21,214  | 23,537  | 21,211 |
| % YoY                    |         |         |         |         | 71.0%  | 38.4%  | 36.5%   | 40.3%   | 10.5%  |
| % QoQ                    |         |         |         |         | 14.3%  | 1.5%   | 8.9%    | 11.0%   | -9.9%  |
| Total production cost    | 10,487  | 11,730  | 13,278  | 14,691  | 16,937 | 17,738 | 18,421  | 19,647  | 17,886 |
| Gross profit             | 733     | 2,341   | 2,260   | 2,091   | 2,250  | 1,738  | 2,793   | 3,890   | 3,325  |
| Gross margin (%)         | 7.0%    | 20.0%   | 17.0%   | 14.2%   | 13.3%  | 9.8%   | 15.2%   | 19.8%   | 18.6%  |
| Opex                     | (1,332) | (1,073) | (1,192) | (1,378) | (985)  | (794)  | (1,045) | (1,424) | (964)  |
| Operating profit         | (599)   | 1,268   | 1,068   | 713     | 1,265  | 944    | 1,748   | 2,466   | 2,361  |
| Operating margin (%)     | -5.3%   | 9.0%    | 6.9%    | 4.2%    | 6.6%   | 4.8%   | 8.2%    | 10.5%   | 11.1%  |
| Non-operating expenses   | (179)   | (176)   | (218)   | (263)   | (166)  | (160)  | (247)   | (169)   | (255)  |
| Pre-tax profit           | (778)   | 1,092   | 850     | 450     | 1,099  | 784    | 1,501   | 2,297   | 2,106  |
| Pre-tax margin (%)       | -6.9%   | 7.8%    | 5.5%    | 2.7%    | 5.7%   | 4.0%   | 7.1%    | 9.8%    | 9.9%   |
| Income tax               | -175    | 186     | 181     | -187    | 23     | 15     | 14      | -184    | 517    |
| Minority interests       | 0       | -3      | -7      | 9       | 8      | 0      | 4       | -5      | -2     |
| Net profit               | (603)   | 909     | 676     | 628     | 1,068  | 769    | 1,483   | 2,486   | 1,591  |
| Net margin (%)           | -5.4%   | 6.5%    | 4.4%    | 3.7%    | 5.6%   | 3.9%   | 7.0%    | 10.6%   | 7.5%   |
| Recurring net profit     | (615)   | 917     | 677     | 636     | 1,069  | 757    | 1,468   | 2,362   | 1,590  |
| Recurring net margin (%) | -5.5%   | 6.5%    | 4.4%    | 3.8%    | 5.6%   | 3.9%   | 6.9%    | 10.0%   | 7.5%   |
| Basic EPS (RMB/share)    | -0.09   | 0.13    | 0.09    | 0.09    | 0.15   | 0.10   | 0.20    | 0.32    | 0.22   |
| Diluted EPS (RMB/share)  | -0.09   | 0.13    | 0.09    | 0.09    | 0.15   | 0.10   | 0.2     | 0.32    | 0.22   |

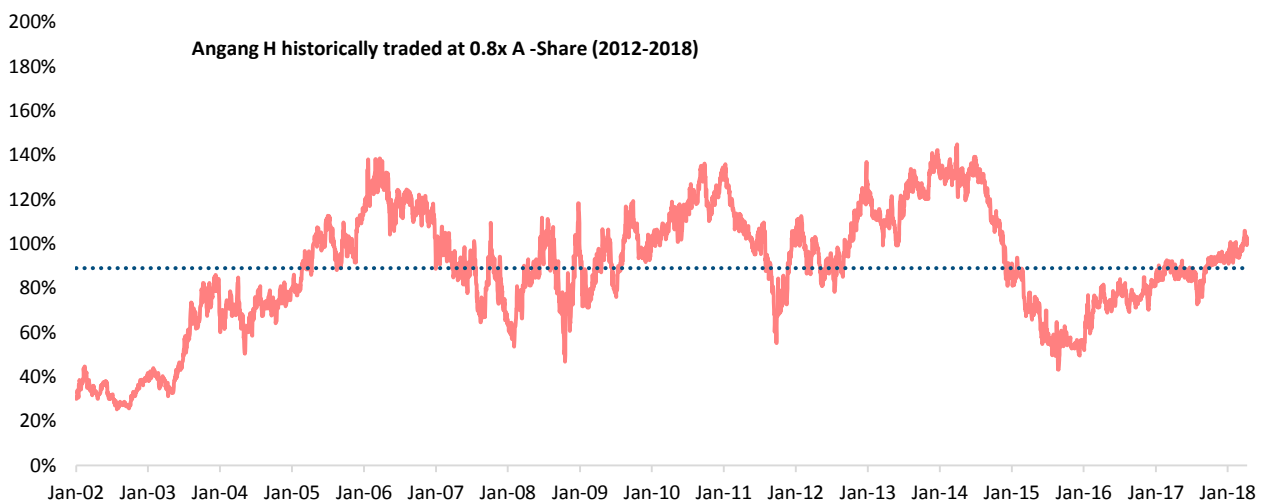
Source: Company data, Bloomberg, CSCI Research

**Figure 2: 12M forward PER**


Source: Bloomberg, CSCI Research estimates

**Figure 3: 12M forward PBR**


Source: Bloomberg, CSCI Research estimates

**Figure 4: Angang's share price performance**


Source: Bloomberg

**Income statement (RMB mn)**

| Year end: Dec               | 2015           | 2016         | 2017          | 2018E         | 2019E         |
|-----------------------------|----------------|--------------|---------------|---------------|---------------|
| Revenue                     | 52,759         | 57,882       | 84,310        | 86,317        | 86,317        |
| COGS                        | (49,693)       | (50,457)     | (73,639)      | (72,160)      | (72,160)      |
| <b>Gross profit</b>         | <b>3,066</b>   | <b>7,425</b> | <b>10,671</b> | <b>14,156</b> | <b>14,156</b> |
| Selling expenses            | (2,311)        | (1,928)      | (2,334)       | (2,390)       | (2,390)       |
| General and administrative  | (1,808)        | (1,626)      | (1,807)       | (1,850)       | (1,850)       |
| Other opex                  | (1,704)        | (1,300)      | (227)         | (232)         | (232)         |
| <b>Operating profit</b>     | <b>(2,757)</b> | <b>2,571</b> | <b>6,303</b>  | <b>9,684</b>  | <b>9,684</b>  |
| Net interest expense        | (1,346)        | (1,286)      | (1,174)       | (935)         | (682)         |
| JVs and associates          | 340            | 335          | 351           | 359           | 359           |
| <b>Pretax profit</b>        | <b>(3,763)</b> | <b>1,620</b> | <b>5,480</b>  | <b>9,109</b>  | <b>9,361</b>  |
| Taxation                    | (837)          | (5)          | 132           | (2,733)       | (2,808)       |
| Minority interests          | 7              | 1            | (7)           | (8)           | (8)           |
| <b>Net profit</b>           | <b>(4,593)</b> | <b>1,616</b> | <b>5,605</b>  | <b>6,368</b>  | <b>6,545</b>  |
| Net profit (adjusted)       | (4,593)        | 1,616        | 5,605         | 6,368         | 6,545         |
| <b>EBIT</b>                 | <b>(2,410)</b> | <b>2,907</b> | <b>6,647</b>  | <b>10,036</b> | <b>10,036</b> |
| Depreciation & Amortization | (3,925)        | (3,451)      | (3,492)       | (3,465)       | (3,328)       |
| <b>EBITDA</b>               | <b>1,515</b>   | <b>6,358</b> | <b>10,139</b> | <b>13,501</b> | <b>13,363</b> |
| Basic EPS (RMB)             | (0.63)         | 0.22         | 0.77          | 0.88          | 0.90          |
| Diluted EPS (RMB)           | (0.63)         | 0.22         | 0.77          | 0.88          | 0.90          |
| DPS (RMB)                   | -              | 0.07         | 0.23          | 0.26          | 0.27          |

**Balance sheet (RMB mn)**

| Year end: Dec                      | 2015          | 2016          | 2017          | 2018E         | 2019E         |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Cash                               | 3,601         | 1,968         | 2,437         | 8,709         | 12,125        |
| Short term investments             | -             | -             | -             | -             | -             |
| Accounts receivables               | 8,311         | 8,352         | 9,693         | 9,237         | 9,237         |
| Inventory                          | 8,008         | 10,466        | 11,643        | 10,827        | 10,827        |
| Other current assets               | 3,675         | 5,194         | 4,803         | 4,595         | 4,595         |
| <b>Total current assets</b>        | <b>23,595</b> | <b>25,980</b> | <b>28,576</b> | <b>33,368</b> | <b>36,784</b> |
| PP&E                               | 51,014        | 49,065        | 48,006        | 46,041        | 44,213        |
| Intangible Assets                  | 6,086         | 5,755         | 6,199         | 6,199         | 6,199         |
| Total investments                  | 3,522         | 3,807         | 3,668         | 3,668         | 3,668         |
| Other long term assets             | 4,379         | 3,766         | 2,755         | 2,755         | 2,755         |
| <b>Total long term assets</b>      | <b>65,001</b> | <b>62,393</b> | <b>60,628</b> | <b>58,663</b> | <b>56,835</b> |
| <b>TOTAL ASSETS</b>                | <b>88,596</b> | <b>88,373</b> | <b>89,204</b> | <b>92,030</b> | <b>93,619</b> |
| Short term debt                    | 16,319        | 18,995        | 14,500        | 12,242        | 9,984         |
| Accounts payables                  | 5,799         | 10,055        | 8,436         | 9,055         | 9,055         |
| Other current liabilities          | 20,886        | 8,043         | 10,162        | 10,904        | 10,904        |
| <b>Total current liabilities</b>   | <b>43,004</b> | <b>37,093</b> | <b>33,098</b> | <b>32,201</b> | <b>29,943</b> |
| Long term debt                     | 962           | 1,296         | 2,905         | 2,163         | 1,421         |
| Deferred tax                       | 949           | 752           | 811           | 811           | 811           |
| Bonds payable                      | -             | 3,944         | 2,004         | 2,004         | 2,004         |
| Other long term liabilities        | -             | -             | -             | -             | -             |
| <b>Total long term liabilities</b> | <b>1,911</b>  | <b>5,992</b>  | <b>5,720</b>  | <b>4,978</b>  | <b>4,236</b>  |
| <b>TOTAL LIABILITIES</b>           | <b>44,915</b> | <b>43,085</b> | <b>38,818</b> | <b>37,179</b> | <b>34,179</b> |
| Shareholders' funds                | 43,274        | 44,882        | 49,973        | 54,430        | 59,011        |
| Minority Interests                 | 407           | 406           | 413           | 421           | 429           |
| <b>TOTAL LIAB AND EQUITY</b>       | <b>88,596</b> | <b>88,373</b> | <b>89,204</b> | <b>92,030</b> | <b>93,619</b> |
| Net cash / (debt)                  | (13,680)      | (22,267)      | (16,972)      | (7,700)       | (1,284)       |

Source: Company data, Bloomberg, CSCI Research estimates

**Cash flow statement (RMB mn)**

| Year end: Dec                    | 2015           | 2016           | 2017           | 2018E          | 2019E          |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>EBIT</b>                      | <b>(2,410)</b> | <b>2,907</b>   | <b>6,647</b>   | <b>10,036</b>  | <b>10,036</b>  |
| Depreciation & amortisation      | 3,925          | 3,451          | 3,492          | 3,465          | 3,328          |
| Net interest                     | 1,346          | 1,286          | 1,174          | 935            | 682            |
| Taxes paid                       | (837)          | (5)            | 132            | (2,733)        | (2,808)        |
| Changes in working capital       | 4,407          | (1,605)        | (3,949)        | 2,841          | -              |
| Others                           | (1,294)        | (1,704)        | (1,228)        | (1,861)        | (1,357)        |
| <b>Cash flow from operations</b> | <b>5,137</b>   | <b>4,330</b>   | <b>6,268</b>   | <b>12,683</b>  | <b>9,881</b>   |
| Capex                            | (3,807)        | (1,393)        | (1,868)        | (1,500)        | (1,500)        |
| Acquisitions                     | (70)           | (70)           | (86)           | -              | -              |
| Disposals                        | 4              | 148            | 1              | -              | -              |
| Others                           | 1,145          | 765            | 608            | -              | -              |
| <b>Cash flow from investing</b>  | <b>(2,728)</b> | <b>(550)</b>   | <b>(1,345)</b> | <b>(1,500)</b> | <b>(1,500)</b> |
| Dividends                        | (1,782)        | (1,303)        | (1,531)        | (1,911)        | (1,964)        |
| Issue of shares                  | -              | -              | -              | -              | -              |
| Change in debt                   | 1,262          | (4,107)        | (2,918)        | (3,000)        | (3,000)        |
| Others                           | 4              | (3)            | (5)            | -              | -              |
| <b>Cash flow from financing</b>  | <b>(516)</b>   | <b>(5,413)</b> | <b>(4,454)</b> | <b>(4,911)</b> | <b>(4,964)</b> |
| <b>Change in cash</b>            | <b>1,893</b>   | <b>(1,633)</b> | <b>469</b>     | <b>6,272</b>   | <b>3,417</b>   |
| Free cash flow                   | 1,330          | 2,937          | 4,400          | 11,183         | 8,381          |

**Key ratios**

| Year end: Dec            | 2015   | 2016 | 2017  | 2018E | 2019E |
|--------------------------|--------|------|-------|-------|-------|
| <b>Operating ratios</b>  |        |      |       |       |       |
| Gross margin             | 5.8    | 12.8 | 12.7  | 16.4  | 16.4  |
| EBITDA margin (%)        | 2.9    | 11.0 | 12.0  | 15.6  | 15.5  |
| Effective tax rate (%)   | (22.2) | 0.3  | (2.4) | 30.0  | 30.0  |
| Revenue growth (%)       | -      | 9.7  | 45.7  | 2.4   | -     |
| Net income growth (%)    | -      | -    | 246.8 | 13.6  | 2.8   |
| EPS growth adj (%)       | -      | -    | 246.8 | 13.6  | 2.8   |
| DPS growth (%)           | -      | -    | 246.8 | 13.6  | 2.8   |
| <b>Efficiency ratios</b> |        |      |       |       |       |
| ROE (%)                  | (10.6) | 3.6  | 11.2  | 11.7  | 11.1  |
| ROCE (%)                 | (6.0)  | 5.0  | 11.2  | 16.2  | 15.2  |
| Asset turnover (x)       | 0.6    | 0.7  | 0.9   | 0.9   | 0.9   |
| Op cash / EBIT (x)       | (1.9)  | 1.7  | 1.0   | 1.3   | 1.0   |
| Depreciation / CAPEX (x) | 1.0    | 2.5  | 1.9   | 2.3   | 2.2   |
| Accounts receivable days | 68.8   | 62.2 | 48.6  | 50.0  | 48.6  |
| Accounts payable days    | 68.0   | 78.6 | 51.4  | 47.9  | 51.4  |
| <b>Leverage ratios</b>   |        |      |       |       |       |
| Net gearing (%)          | 31.6   | 49.6 | 34.0  | 14.1  | 2.2   |
| Net debt / EBITDA (x)    | 9.0    | 3.5  | 1.7   | 0.6   | 0.1   |
| Interest cover (x)       | (2.0)  | 2.0  | 5.4   | 10.4  | 14.2  |
| Current ratio (x)        | 0.5    | 0.7  | 0.9   | 1.0   | 1.2   |
| <b>Valuation</b>         |        |      |       |       |       |
| PER (x)                  | -      | 29.6 | 8.5   | 7.5   | 7.3   |
| EV/EBITDA (x)            | 50.5   | 12.6 | 7.4   | 4.9   | 4.5   |
| PBR (x)                  | 1.1    | 1.1  | 1.0   | 0.9   | 0.8   |
| Dividend yield (%)       | -      | 1.0  | 3.5   | 4.0   | 4.1   |



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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

|             |                                                        |
|-------------|--------------------------------------------------------|
| <b>Buy</b>  | 12-month absolute total return: $\geq 10\%$            |
| <b>Hold</b> | 12-month absolute total return: $> -10\%$ but $< 10\%$ |
| <b>Sell</b> | 12-month absolute total return: $\leq -10\%$           |

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