

Equity Research | China | Metals

18 May 2018

Favourable trend of product mix

- Magang's positive earnings growth in the first quarter, driven by higher unit gross dollar margins, reaffirms our view that the industry earnings uptrend remains intact.
- In our view, we believe the outlook for China's steel industry would remain stable amid the current supply-side industry reforms.
- We have revised up our FY18E revenue and net profit estimates slightly by 3.2%/1.0%, respectively, on anticipation of higher steel product prices to outweigh cost pressure. Our price target remains unchanged at HKD4.5, based on 1.0x FY18E BVPS; maintain BUY.

Another year of solid growth amid deepening supply-side reforms. As the Chinese government has planned to shut down 30mn tons of obsolete capacity, whereas the apparent consumption of steel is expected to remain stable from 2018 to 2020. On the production front, the latest operating rate of China's national blast furnace has rebounded to the level of the pre-winter closure period. China's steel inventory has continued to come down since mid-Mar with downstream consumption picking up. Meanwhile, stabilisation in Asean hot rolled coil import and Middle East rebar spot prices reflects the impact of the U.S. tariffs on steel is diminishing. And in spite of the rebound in the iron ore import price led by the growing demand for higher grade materials and upsurge in coking coal prices amid insufficient domestic supply, the price spread between steel products and raw materials has recovered towards the Jan year-high.

Prudent business plan bearing fruits. Management guided that the company aims to maintain the scale of its production at last year's level, with crude and steel production to be maintained at 19.85mn tons and 18.82mn tons, respectively. **Since 4Q16, Magang has seen a substantial rebound in the ex-factory prices for most of its products, which boded well for margin expansion in 2017. We believe the uptrend would be sustainable through this year. In view of Magang's management's effort in optimising the product mix towards higher-end steel, we believe Magang would continue to benefit from higher steel prices, leading to higher unit dollar margins from RMB330/ton last year.**

Continuously improving free cash flow. Magang's FY18E capex has been reduced from the FY17 level, with majority of the capex set aside for production upgrade and environmental protection related investment. As such, we foresee Magang to return to a net cash position by year-end, from ND/E at 27.7% end-17.

Room for further re-rating. Magang currently trades at 5.2x FY18E PER, which in our view looks attractive in light of its improving growth prospects. In terms of PBR and ROE, as our price target represents 1.0x FY18E PBR and given our expectation that its ROE will recover to c.16.8% in 2018, i.e. the level equivalent to the period between 2003 and 2005, we deem its current valuation undemanding, and thus, maintain Buy.

Maanshan Iron & Steel (323 HK)

Buy

(unchanged)

Price Target	HK\$4.5
(Revision)	(N/A)
(upside)	(12.5%)

EPS	2018E	2019E
revision	(+1.0%)	(N/A)

Close price	HKD4.0
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Market cap.	HKD34,520 mn
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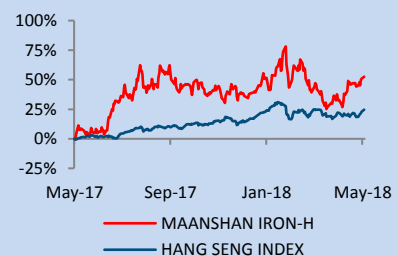
Free float	22.5%
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52-week range	HKD2.58 – 4.75
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3-mth ave. T/O	HKD97.2 mn
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Price as of 17 May 2018

Stock rel HSI performance (%)


Duncan Chan
(CE No.: ALH659)
duncanchan@csci.hk +852 3465 5654

Income statement (RMB mn)

Year end: Dec	2015	2016	2017	2018E	2019E
Revenue	45,109	48,275	73,228	73,313	73,313
COGS	(45,690)	(42,990)	(64,297)	(62,896)	(62,896)
Gross profit	(581)	5,286	8,931	10,417	10,417
Selling expenses	(636)	(695)	(865)	(866)	(866)
General and administrative	(1,539)	(1,780)	(1,419)	(1,421)	(1,421)
Other opex	(1,619)	(881)	(329)	(329)	(329)
Operating profit	(4,375)	1,929	6,317	7,801	7,801
Net interest expense	(813)	(794)	(999)	(846)	(710)
JVs and associates	461	233	490	491	491
Pretax profit	(4,727)	1,369	5,809	7,446	7,581
Taxation	(378)	(112)	(737)	(1,861)	(1,895)
Minority interests	300	(28)	(943)	(1,039)	(1,057)
Net profit	(4,804)	1,229	4,129	4,546	4,629
Net profit (adjusted)	(4,804)	1,229	4,129	4,546	4,629
EBIT	(3,613)	2,134	5,864	7,253	7,234
Depreciation & Amortization	(3,380)	(3,326)	(3,550)	(3,747)	(3,670)
EBITDA	(233)	5,461	9,415	11,000	10,904
Basic EPS (RMB)	(0.62)	0.16	0.54	0.59	0.60
Diluted EPS (RMB)	(0.62)	0.16	0.54	0.59	0.60
DPS (RMB)	-	-	0.16	0.18	0.18

Balance sheet (RMB mn)

Year end: Dec	2015	2016	2017	2018E	2019E
Cash	5,143	5,312	4,978	10,060	12,027
Short term investments	-	-	-	-	-
Accounts receivables	4,689	3,608	8,375	5,999	5,999
Inventory	6,018	10,548	11,446	10,754	10,754
Other current assets	4,310	4,950	7,299	7,247	7,247
Total current assets	20,160	24,418	32,099	34,060	36,027
PP&E	34,605	35,523	33,130	32,384	31,714
Intangible Assets	1,891	1,822	1,884	1,884	1,884
Total investments	1,159	1,818	2,636	2,636	2,636
Other long term assets	4,639	2,665	2,443	2,443	2,443
Total long term assets	42,294	41,827	40,093	39,346	38,677
TOTAL ASSETS	62,454	66,246	72,192	73,406	74,704
Short term debt	6,791	6,943	4,630	3,474	1,740
Accounts payables	6,145	6,669	6,969	6,668	6,668
Other current liabilities	16,795	19,939	24,519	23,814	23,814
Total current liabilities	29,731	33,550	36,118	33,956	32,222
Long term debt	6,655	5,163	6,976	6,132	4,867
Deferred tax	1,347	1,464	1,860	1,860	1,860
Bonds payable	3,980	3,988	-	-	-
Other long term liabilities	-	-	-	-	-
Total long term liabilities	11,982	10,615	8,836	7,992	6,727
TOTAL LIABILITIES	41,713	44,165	44,954	41,949	38,949
Shareholders' funds	18,456	19,764	23,896	27,078	30,318
Minority Interests	2,286	2,316	3,342	4,380	5,437
TOTAL LIAB AND EQUITY	62,454	66,246	72,192	73,406	74,704
Net cash / (debt)	(12,283)	(10,782)	(6,628)	454	5,421

Source: Company data, Bloomberg, CSCI Research estimates

Cash flow statement (RMB mn)

Year end: Dec	2015	2016	2017	2018E	2019E
EBIT	(3,613)	2,134	5,864	7,253	7,234
Depreciation & amortisation	3,380	3,326	3,550	3,747	3,670
Net interest	813	794	999	846	710
Taxes paid	(378)	(112)	(737)	(1,861)	(1,895)
Changes in working capital	5,325	(1,634)	(5,317)	2,114	-
Others	338	(310)	1,097	(654)	(363)
Cash flow from operations	5,865	4,198	5,457	11,446	9,356
Capex	(2,773)	(2,131)	(1,485)	(3,000)	(3,000)
Acquisitions	(5,478)	(532)	(2,634)	-	-
Disposals	4,324	480	603	-	-
Others	306	245	102	-	-
Cash flow from investing	(3,621)	(1,938)	(3,414)	(3,000)	(3,000)
Dividends	(1,081)	(963)	(956)	(1,364)	(1,389)
Issue of shares	-	-	-	-	-
Change in debt	(4,455)	(1,128)	(1,723)	(2,000)	(3,000)
Others	3,981	-	303	-	-
Cash flow from financing	(1,555)	(2,091)	(2,377)	(3,364)	(4,389)
Change in cash	689	169	(334)	5,082	1,967
Free cash flow	3,093	2,067	3,973	8,446	6,356

Key ratios

Year end: Dec	2015	2016	2017	2018E	2019E
Operating ratios					
Gross margin	(1.3)	10.9	12.2	14.2	14.2
EBITDA margin (%)	(0.5)	11.3	12.9	15.0	14.9
Effective tax rate (%)	(8.0)	8.2	12.7	25.0	25.0
Revenue growth (%)	-	7.0	51.7	0.1	-
Net income growth (%)	-	(125.6)	236.0	10.1	1.8
EPS growth adj (%)	-	(125.6)	236.0	10.1	1.8
DPS growth (%)	-	-	-	7.3	1.8
Efficiency ratios					
ROE (%)	(26.0)	6.2	17.3	16.8	15.3
ROCE (%)	(13.4)	5.9	17.5	19.8	18.4
Asset turnover (x)	0.7	0.7	1.0	1.0	1.0
Op cash / EBIT (x)	(1.3)	2.2	0.9	1.5	1.2
Depreciation / CAPEX (x)	1.2	1.6	2.4	1.2	1.2
Accounts receivable days	60.0	37.6	34.4	40.5	34.4
Accounts payable days	92.2	93.2	63.3	66.2	63.3
Leverage ratios					
Net gearing (%)	66.6	54.6	27.7	(1.7)	(17.9)
Net debt / EBITDA (x)	(52.7)	2.0	0.7	(0.0)	(0.5)
Interest cover (x)	(5.4)	2.4	6.3	9.2	11.0
Current ratio (x)	0.7	0.7	0.9	1.0	1.1
Valuation					
PER (x)	(4.9)	19.1	5.7	5.2	5.1
EV/EBITDA (x)	(103.8)	9.0	4.6	3.4	3.0
PBR (x)	1.1	1.1	0.9	0.7	0.7
Dividend yield (%)	-	-	5.4	5.8	5.9



Research

LIU Taisheng, Steven
TMT
(852) 3465 5652
stevenliu@csci.hk

CHAN Ka Yeung, Duncan
Commodity
(852) 3465 5654
duncanchan@csci.hk

TIAN Yang
Automotive
(852) 3465 5775
tianyong@csci.hk

YAO Xue, Snowy
Power & coal
snowyyao@csci.hk
+852 3465 5675

SHEN Xiangfei, Thomas
(852) 3465 8689
thomasshen@csci.hk

XU Qiwen
(852) 3465 8690
xuqiwen@csci.hk

Institutional Sales & Trading

XIANG Xinrong, Ron
(852) 3465 5633
ronxiang@csci.hk

HO Wen Hao, Jack
(852) 3465 5685
jackho@csci.hk

WANG Zhuo, Gary
(852) 3465 8655
wangzhuo@csci.hk

LEE Ying Ju, Rose
(852) 3465 5707
roselee@csci.hk

LI Jiageng, Mike
(852) 3465 5636
mikeli@csci.hk

XIA Tian
(852) 3465 5670
xiatian@csci.hk

XU Xiaowei, Vincent
(852) 3465 5795
vincentxu@csci.hk

Company Rating Definition

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

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

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China Securities (International) Research

18/F, Two Exchange Square, Central, Hong Kong

Tel: (852) 34655600 Fax: (852) 21809495

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