



Company Report: China Hongqiao (01378 HK)

公司报告: 中国宏桥 (01378 HK)

Kevin Guo 郭勇 (86755) 2397 6671 kevin.guo@gtjas.com

25 May 2018

2017 Annual Results Missed Expectations, Downgrade to "Neutral"

2017年年度业绩差于预期,下调至"中性"评级

- The 2017 annual results of the Company was 12.1% and 18.7% lower than market consensus and our estimation. Total revenue of the Company increased by 52.0% yoy to RMB 93.31 billion, but net profit attributable to shareholders decreased by 25.3% yoy to RMB 5.12 billion.
- We expect the Company to produce about 6.00 million tons of primary aluminum in 2018. Production capacity expansion period of the Company had come to an end in 2017 and the Company's output of primary aluminum in 2018-2020 is expected to remain at the level of about 6.00 million tons.
- We expect aluminum prices to continue to rebound in 2018 and the average annual aluminum price to be around USD 2,150/t. We expect the policy of supply-side reform in the primary aluminum industry to be sustained in the coming years, and the production capacity in China is not expected to grow.
- We expect the financial statements of the Company to improve significantly in 2018-2020.
- Revise down TP to HK\$ 8.71 and downgrade to "Neutral".
- 公司 2017 年年度业绩比市场一致预期和我们的估计分别低 12.1%和 18.7%。公司收入同 比增长 52.0%至人民币 933.1 亿元,但股东净利同比下降 25.3%至人民币 51.2 亿元。
- 我们预计公司在 2018 年将生产 600 万吨原铝。公司的产能扩张期从 2017 年起已结束,公司 2018-2020 年的原铝产量预计将维持在 600 万吨的水平。
- **我们预计铝价在 2018 年将会继续反弹,全年铝均价将在 2,150 美元/吨左右。**我们预计未来电解铝行业的供给侧改革政策将持续,中国的产能预计将不会增长。
- 我们预计公司的财务状况在 2018-2020 年将显著改善。
- 下调公司目标价至 8.71 港元,下调至"中性"评级。

Rating:	Neutral
	Downgraded

评级: **中性** (下调)

6-18m TP 目标价: HK\$8.71
Revised from 原目标价: HK\$14.07

Share price 股价: HK\$8.620

Stock performance



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 %	(2.0)	(7.2)	24.5
Rel. % to HS Index 相对恒指变动 %	(2.5)	(5.6)	3.6
Avg. Share price(HK\$) 平均股价 (港元)	8.6	9.0	8.1

Source: Bloomberg, Guotai Junan International.

FY18 Est. NAV (HK\$) FY18 每股估值(港元)

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)	(△ %)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2016A	61,396	6.850	0.960	62.7	8.0	6.397	1.2	0.470	6.1	17.1
2017A	93,313	5,119	0.697	(27.4)	10.0	7.247	1.0	0.200	2.9	10.7
2018F	80,333	8,373	1.140	63.6	6.1	8.253	0.8	0.137	2.0	15.3
2019F	83,080	9,343	1.272	11.6	5.5	9.396	0.7	0.153	2.2	14.9
2020F	84,980	9,990	1.360	6.9	5.1	10.618	0.7	0.163	2.3	14.1
Shares in iss	ue (m) 总股数	(m)		7,343.3	Major s	hareholder 大股	东		Zhang	Shiping 81.2%
Market cap.	cap. (HK\$ m) 市值 (HK\$ m) 63,299.2 Free float (%) 自由流通比率 (%)					18.8%				
3 month avei	nonth average vol. 3 个月平均成交股数 ('000)				FY18 N	et gearing (%) F	Y18 净负债/	股东资金 (%)		77.9

12.881 / 6.921

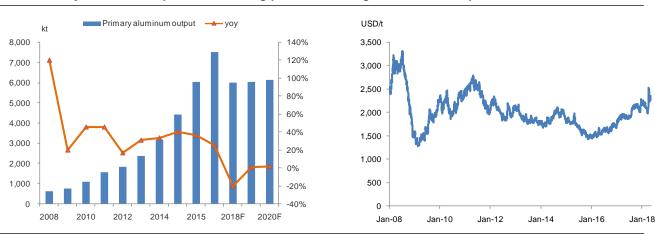
52 Weeks high/low (HK\$) 52 周高/低 (HK\$) Source: the Company, Guotai Junan International.

12.8



The 2017 annual results of the Company was 12.1% and 18.7% lower than market consensus and our estimation, mainly due to provisions for impairment of assets and the increase in the price of certain raw materials. Total revenue of the Company increased by 52.0% yoy to RMB 93.31 billion, but net profit attributable to shareholders decreased by 25.3% yoy to RMB 5.12 billion. The output of primary aluminum increased by 24.9% yoy to 7.54 million tons. Aluminum prices rebounded significantly due to the supply-chain reform in China and the ASP of the Company increasing by 14.6% yoy to RMB 12,367/t in 2017. However, the rise in coal prices and other raw materials was much higher than that in aluminum, which led to lower gross margin. The gross margin of aluminum products in 2017 was down 7.1 ppts to only 16.0%. The Company had shut down projects with annual production capacity of approximately 2.68 million tons according to government regulations and action plans, which represents approximately 29% of the Company's total production capacity of aluminum products. The shutdown of unlawful production capacity and the acquisition of an A-share listed company resulted in impairment loss of PPE (property, plant and equipment) and goodwill of about RMB 5.68 billion.

Figure-1: Primary aluminum output of China Hongqiao



Source: the Company, Guotai Junan International.

Source: Bloomberg, Guotai Junan International.

Figure-2: Aluminum price

We expect the Company to produce about 6.0 million tons of primary aluminum in 2018. Production capacity expansion period of the Company came to an end in 2017 and the Company's output of primary aluminum in 2018-2020 is expected to remain at the level of about 6.00 million tons. The Company added 5.67 million tons of primary aluminum production capacity in 2011-2016 and became the largest primary aluminum producer in the world. However, policy environments thoroughly changed in 2017. The Chinese government strongly executed policy on capacity cuts and deleveraging. The closing of 2.68 million tons of production capacity of the Company is an obvious example. As a result, new production capacity of primary aluminum will not be easily approved by the government. On the other hand, debt burden of the Company surged with the expansion of production capacity. The leverage level of the Company will also not support the Company to continue to expand under current policy circumstances. The Company operates 6.46 million tons of production capacity, which was all filed properly in accordance with relevant regulations. We expect the Company to produce 6.00 million tons of primary aluminum in 2018-2020 considering production constraints during winter seasons. We expect the output the primary aluminum of the Company to be stable in the future.

We expect aluminum prices to continue to rebound in 2018 and the average annual aluminum price to be around USD 2,150/t. The fundamental basis of aluminum changed greatly in 2017 when the Chinese government launched supply-side reform and the execution of production capacity cuts exceeded market expectations greatly. As the largest aluminum producer in the world, the significant production capacity cut in China was enough to thoroughly change global supply-demand balance. The output of primary aluminum in China significantly slowed and even recorded negative growth in several months. We expect the policy of supply-side reform in primary aluminum industry to be sustained in the coming years and the production capacity in China is not expected to grow. We expect aluminum price to be strongly supported by production constraints in China. We expect the rise in aluminum price to be sustained in 2018 and aluminum price to stay above the level of USD 2,000/t in 2018. We expect the average annual aluminum price to be around USD 2,150/t.

We expect the financial statements of the Company improve significantly in 2018-2020. Total debt burden of the Company surged significantly up until 2017 due to the fast production capacity expansion of the Company. Total capital expenditure of the Company remained at the level of about RMB 20 billion over the past 3 years. Total bank borrowings and



debentures reached more than RMB 65 billion according to the 2017 annual results of the Company. Total financial costs surpassed RMB 4.0 billion in the 2017 annual results. However, we expect the financial statements of the Company to improve from 2017. With the rebound in aluminum price, the profitability of the Company remains robust and the total operating cash flow of the Company exceeded RMB 32 billion in 2017, and is expected to continue to grow in 2018-2020. As the production capacity of the Company comes to an end, the period of huge capital expenditure will also be over. As a result, we will witness total debt of the Company to start to decline starting 2018.

Revise down TP to HK\$ 8.71 and downgrade to "Neutral". China Hongqiao is a large integrated electricity-aluminum manufacturer with significant production cost advantages in the industry. We believe the Company still holds great competitive advantages due to its unique operation model. The compelling production cost advantages of China Hongqiao are mainly contributed by the high self-sufficiency ratio of electricity and alumina, close geographical proximity to upstream suppliers and downstream customers, and advanced manufacturing technology which has lead to low power consumption levels for each ton of primary aluminum produced. The Company continued to raise its self-sufficiency ratio of electricity and alumina, which will further enhance competitive advantages. After the shutdown of unlawful aluminum production capacities, regulation risks of the Company dropped significantly. We expect the output of aluminum of the Company to remain stable at the level of about 6 million tons in 2018-2020. We expect the expansion period of the Company to come to an end, hence capital expenditure of the Company is also expected to drop starting 2018, and the financial statements of the Company to improve significantly. We expect aluminum price to continue to rebound in 2018 and stay above the level of US\$ 2,000/t in 2018. Although the surge in coal and carbon anode block prices seriously eroded the profitability of the Company, the Company will still earn a huge profit with the rebound in aluminum price. However, the Company still confronts some policy uncertainties, mainly regarding compensatory payment of its power station. We revise down the TP of the Company to HK\$ 8.71, which represents 6.5x FY18 PE, and downgrade to "Neutral".



Table-1: Peers Comparison

Company	Stock Code	Cumanau	Look majoo		PE (fiscal	year)		PB (fiscal year)			ROE(%)	
Company	Stock Code	Currency	Last price	17A	18F	19F	20F	17A	18F	19F	20F	18F
International Listed companies												
Alcoa Inc	AA US	USD	48.57	41.2	10.7	11.2	13.3	2.0	1.6	1.4	1.3	14.5
Norsk Hydro Asa	NHY NO	NOK	50.38	11.7	12.9	11.0	10.1	1.2	1.1	1.1	1.0	9.1
Aluar Aluminio	ALUA AR	ARS	17.20	24.6	17.7	20.7	n.a.	5.1	n.a.	n.a.	n.a.	n.a.
Hindalco Industries Ltd	HNDL IN	INR	231.90	25.2	8.5	9.3	8.6	1.1	n.a.	1.0	0.9	9.8
National Aluminium Co Ltd	NACL IN	INR	70.85	23.9	12.4	10.4	9.4	1.3	n.a.	n.a.	n.a.	10.3
Simple Average				25.3	12.5	12.5	10.4	2.2	1.4	1.1	1.0	10.9
Weighted Average				24.2	11.6	11.2	10.6	1.6	1.3	1.1	1.1	10.9
PRC listed companies												
Aluminum Corp Of China Ltd-A	601600 CH	CNY	4.38	48.7	23.3	15.2	13.4	1.7	1.5	1.4	1.3	6.2
Shandong Nanshan Aluminum-A	600219 CH	CNY	3.10	18.2	12.6	9.8	10.7	0.9	0.9	8.0	0.7	6.0
Henan Shenhuo Coal & Power-A	000933 CH	CNY	6.08	31.4	9.2	7.8	10.0	2.0	1.4	1.2	1.1	13.7
Simple Average				32.8	15.0	10.9	11.4	1.5	1.3	1.1	1.0	8.6
Weighted Average				38.1	18.7	12.8	12.3	1.5	1.3	1.2	1.1	7.0
HK listed companies												
China Hongqiao Group Ltd	1378 HK	HKD	8.62	10.7	6.3	4.4	4.2	1.1	1.0	0.8	0.8	15.3
Aluminum Corp Of China Ltd-H	2600 HK	HKD	4.13	39.7	20.0	14.5	11.3	1.3	1.2	1.1	1.0	5.7
United Co Rusal Plc	486 HK	HKD	2.02	3.2	2.4	2.2	2.4	0.9	0.7	0.5	0.5	32.9
Simple Average				17.9	9.6	7.1	6.0	1.1	1.0	0.8	0.7	18.0
Weighted Average				18.1	9.7	7.0	6.0	1.1	1.0	0.9	0.8	14.6

Source: Bloomberg, Guotai Junan International.

2019F

2020F

25 May 2018

Financial Statements and Ratios

Income Statement						
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F	
Total Revenue	61,396	93,313	80,333	83,080	84,980	
COGS	(47,199)	(78,429)	(67,641)	(69,654)	(71,455)	
Gross profit	14,196	14,884	12,693	13,426	13,525	
Distribution & Selling expenses	(164)	(270)	(281)	(291)	(297)	
Administrative expenses	(2,081)	(2,062)	(1,848)	(1,911)	(1,955)	
Operating Profit	11,952	12,552	10,564	11,224	11,273	
Other gains and losses	1,159	(1,380)	4,127	4,345	4,574	
Finance costs	(3,346)	(4,080)	(3,238)	(2,780)	(2,145)	
Profit Before Tax	9,764	7,092	11,453	12,789	13,702	
Income Tax	(2,949)	(1,785)	(2,863)	(3,197)	(3,425)	
profit After Tax	6,816	5,307	8,590	9,592	10,276	
Non-controlling Interest	34	(188)	(217)	(249)	(286)	
Shareholders' Profit / Loss	6,850	5,119	8,373	9,343	9,990	
Basic EPS	0.960	0.697	1.140	1.272	1.360	

	Cash Flow	Statement			
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Profit before tax	9,764	7,092	11,453	12,789	13,702
Adjust for depre.&amort.	5,605	7,062	7,741	8,249	8,720
Change in WC	(7,777)	5,696	(1,693)	(1,779)	(661
Income tax paid	(2,949)	(1,785)	(2,863)	(3,197)	(3,425
Others	3,294	12,222	(9,988)	3,395	2,90
Cash from Operating Activities	7,937	30,287	4,650	19,457	21,24
Capital expenditure	(20,830)	(9,753)	(7,050)	(6,500)	(6,500
Others	(378)	651	(371)	(351)	(332
Cash from Investing Activities	(21,208)	(9,102)	(7,421)	(6,851)	(6,832
Share issue	0	5,485	0	0	
Net cash flow from borrowings	21,758	(10,418)	(2,151)	(8,339)	(10,82
Interest paid	(3,346)	(4,080)	(3,238)	(2,780)	(2,145
Dividend paid	(931)	(3,204)	(1,005)	(1,121)	(1,199
Others	143	115	92	73	5
Cash from Financing Activities	17,625	(12,102)	(6,302)	(12,167)	(14,106
Net Changes in Cash	4,354	9,083	(9,072)	439	30
Cash at Beg of Year	8,489	12,842	21,926	12,853	13,29
Foreign exchange rate changes	0	0	0	0	
Cash at End of Year	12,842	21,926	12,853	13,293	13,59

,					
PPE	86,658	83,986	86,561	84,812	82,592
Prepaid lease payments	3,067	3,807	3,236	2,750	2,338
Deferred tax assets	557	1,785	866	1,069	1,240
Others	3,460	3,198	4,157	4,272	4,152
Total Non-current Assets	93,742	92,776	94,819	92,903	90,322
Cash & Cash Equivalents	12,842	21,926	12,853	13,293	13,597
Inventories	17,143	15,585	14,460	14,954	15,296
Trade and other receivables	10,085	14,124	14,058	14,539	14,872
Prepayments and other receivables	8,299	12,445	12,050	12,462	12,747
Others	397	1,263	1,073	912	775
Total Current Assets	48,780	65,343	54,495	56,161	57,287
Total Assets	142,521	158,118	149,314	149,064	147,609
Bank and other loans	14,311	9,529	8,159	5,820	5,999
Short-term bills	11,000	3,000	8,000	8,000	3,000
Trade and Other Payables	20,110	32,404	29,211	28,819	29,117
Others	1,464	8,375	1,222	1,283	1,347
Total Current Liabilities	49,653	55,265	46,591	43,922	39,463
Median Note	39,720	36,272	33,000	30,000	27,000
Bank and other borrowings	4,697	10,509	8,000	5,000	2,000
Others	2,763	2,855	1,119	1,146	1,173
Total Non-current Liabilities	47,180	49,636	42,119	36,146	30,173
Total Liabilities	96,833	104,902	88,710	80,068	69,636
Total Shareholders' Equity	44,798	51,233	58,461	66,683	75,474
Minority Interest	890	1,984	2,142	2,314	2,499
Total Equity	45,688	53,217	60,603	68,996	77,973

Balance Sheet 2016A

Year end 31 Dec (RMB m)

2017A

2018F

Financial Ratios							
	2016A	2017A	2018F	2019F	2020F		
Margin:							
Gross margin	23.1	16.0	15.8	16.2	15.9		
Net margin	11.2	5.5	10.4	11.2	11.8		
ROE	17.1	10.3	15.3	14.9	14.1		
ROA	4.8	3.2	5.6	6.3	6.8		
Free CF	-12,893	20,534	-2,400	12,957	14,743		
Net gearing	138.9	75.6	77.9	54.8	33.2		

Source: the Company, Guotai Junan International.

Company Report

China Hongqiao 中国宏桥 (01378 HK)



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.

DISCLOSURE OF INTERESTS

- (1) The Analysts and their associates do not serve as an officer of the issuer mentioned in this Research Report.
- (2) The Analysts and their associates do not have any financial interests in relation to the issuer mentioned in this Research Report.
- (3) Except for GREENLAND BROAD (01253 HK), KAISA GROUP (01638 HK), GUOTAI JUNAN I (01788 HK), BINHAI INVESTMENT (02886 HK), GFI MSCI A I (03156 HK), CAM SCSMALLCAP (03157 HK), ZHENRO PPT (06158 HK), LINK HOLDINGS (08237 HK), GFI MSCI A I-R (CNY) (83156 HK), Guotai Junan and its group companies do not hold equal to or more than 1% of the market capitalization of the issuer mentioned in this Research Report.
- (4) Guotai Junan and its group companies have not had investment banking relationships with the issuer mentioned in this Research Report within the preceding 12 months.
- (5) Guotai Junan and its group companies are not making a market in the securities in respect of the issuer mentioned in this Research Report.
- (6) Guotai Junan and its group companies have not employed an individual serving as an officer of the issuer mentioned in this Research Report. There is no officer of the issuer mentioned in this Research Report associated with Guotai Junan and its group companies.

DISCLAIMER

This Research Report does not constitute an invitation or offer to acquire, purchase or subscribe for securities by Guotai Junan Securities (Hong Kong) Limited ("Guotai Junan"). Guotai Junan and its group companies may do business that relates to companies covered in research reports, including investment banking, investment services, etc. (for example, the placing agent, lead manager, sponsor, underwriter or invest proprietarily).

Any opinions expressed in this report may differ or be contrary to opinions or investment strategies expressed orally or in written form by sales persons, dealers and other professional executives of Guotai Junan group of companies. Any opinions expressed in this report may differ or be contrary to opinions or investment decisions made by the asset management and investment banking groups of Guotai Junan.

Though best effort has been made to ensure the accuracy of the information and data contained in this Research Report, Guotai Junan does not guarantee the accuracy and completeness of the information and data herein. This Research Report may contain some forward-looking estimates and forecasts derived from the assumptions of the future political and economic conditions with inherently unpredictable and mutable situation, so uncertainty may contain. Investors should understand and comprehend the investment objectives and its related risks, and where necessary consult their own financial advisers prior to any investment decision.

This Research Report is not directed at, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable law or regulation or which would subject Guotai Junan and its group companies to any registration or licensing requirement within such jurisdiction.

© 2018 Guotai Junan Securities (Hong Kong) Limited. All Rights Reserved. 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