



Company Report: China Hongqiao (01378 HK)

公司报告: 中国宏桥 (01378 HK)

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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:

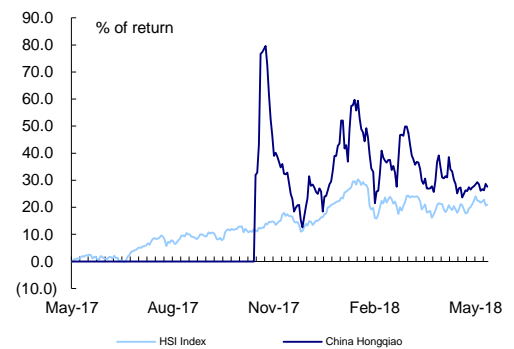
HK\$14.07

Share price 股价:

HK\$8.620

Stock performance

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 %	(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

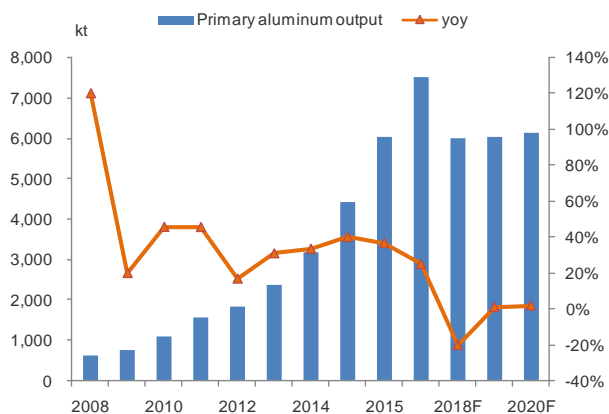
Source: Bloomberg, Guotai Junan International.

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	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 issue (m) 总股数 (m)				7,343.3	Major shareholder 大股东				Zhang Shipping 81.2%	
Market cap. (HK\$ m) 市值 (HK\$ m)				63,299.2	Free float (%) 自由流通比率 (%)					18.8%
3 month average vol. 3 个月平均成交股数 ('000)				6,872.1	FY18 Net gearing (%) FY18 净负债/股东资金 (%)					77.9
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				12.881 / 6.921	FY18 Est. NAV (HK\$) FY18 每股估值 (港元)					12.8

Source: the Company, Guotai Junan International.

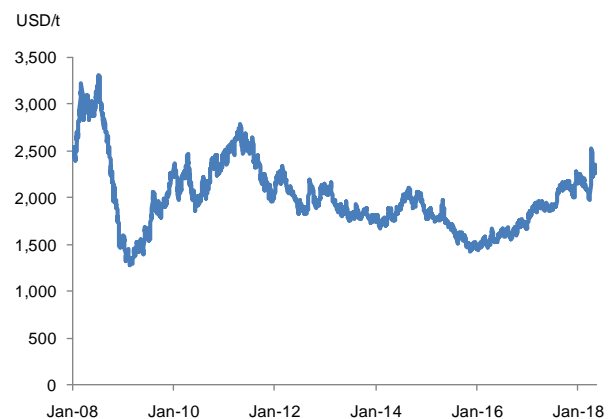
The 2017 annual results of the Company was 12.1% and 18.7% lower than market consensus and our estimation, mainly due to provisions for impairment of assets and the increase in the price of certain raw materials. Total revenue of the Company increased by 52.0% yoy to RMB 93.31 billion, but net profit 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.

Figure-2: Aluminum price



Source: Bloomberg, Guotai Junan International.

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	Currency	Last price	PE (fiscal year)				PB (fiscal year)				ROE(%)
				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	0.8	0.7	6.0
Henan Shenhua 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.

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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