

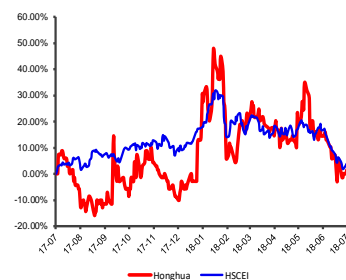
12 July 2018

Outperform  
Unchanged

Market Data: July 11, 2018

Closing Price (HK\$)	0.69
Price Target (HK\$)	0.79
HSCEI	10,658
HSCCI	4,273
52-week High/Low (HK\$)	1.19/0.57
Market Cap (RMB Mn)	2,980
Market Cap (HK\$m)	3,695
Shares Outstanding (m)	5,356
Exchange Rate (Rmb-HK\$)	1.24

Price Performance Chart:



Source: Bloomberg

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Related Reports

"Honghua Group (196:HK) – Well intentioned" 25 May 2018

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## Honghua Group (196:HK)

### Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (HK\$ m)	2,148	2,176	4,100	5,100	6,300
YoY (%)	-44.45	1.32	88.43	24.39	23.53
Net income (HK\$ m)	-610	-1,239	113	333	610
YoY (%)	-	92.21	-	195.08	83.54
EPS (HK\$)	-0.19	-0.26	0.02	0.07	0.13
Diluted EPS (HK\$)	-0.19	-0.26	0.02	0.07	0.13
ROE (%)	-14.36	-30.00	2.65	7.36	12.14
Debt/asset (%)	61.15	58.50	61.15	62.82	62.67
Dividend Yield (%)	-	-	0.67	1.99	3.65
PE (x)	-2.90	-2.10	23.09	7.82	4.26
PB (x)	0.43	0.62	0.60	0.55	0.48
EV/Ebitda (x)	21.67	-30.70	16.05	11.01	9.80

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

昨日，宏华集团发布盈利警告，18年上半年亏损预计同比减少60%-80%，主要归因于强势油价下油服行业持续复苏与公司运营效率的改善。业绩改善幅度低于我们预期，主要由于亏损的海工板块的剥离慢于预期，限制了盈利的进一步提升。因而，我们将18/19/20年的摊薄每股收益预测从人民币0.04/0.10/0.18元下调至0.02/0.07/0.13元，目标价从港币1.06元下调至港币0.79元，对应18/19年27.0/9.0倍市盈率。受油价强势复苏和公司在手订单增加等利好因素推动，宏华未来增长潜力巨大，我们对公司未来发展保持乐观。现价距目标价有14.5%的上涨空间，我们维持增持评级。

**油价支持。**沙特追求其国家油公司IPO高估值的诉求强烈，OPEC成员国对页岩油威胁的担忧依旧，受此影响，OPEC原油增产幅度温和，小于100万桶/天，而我们预计美国对伊朗制裁带来的原油出口量缺口与委内瑞拉的原油产量损失之和大于100万桶/天。在紧供给的拉动下，油价获得长期支持，布伦特原油成功站上75美元/桶，稳步向80美元/桶靠近。高油价拉动全球上游资本支出快速复苏，促进宏华订单流入。18年6月，宏华获得价值5300万美金的钻机新订单，占17年陆地钻机板块收入的81%。

**海工出表延后。**由于与买家协商期延长，我们认为海工板块的剥离将慢于我们预期，相关资产预计于18年底出表。考虑到海工板块17年已全额计提减值损失且17年相关经营性损失预计为人民币1亿元，我们上调了18年海工板块的亏损预测至人民币1亿元。虽然短期亏损增加，但我们认为这一战略性出售在长期仍将利好宏华，这一出售不仅让公司摆脱了17年占总经营性亏损三分之一的海工资产，而且出售获得的现金占16年年底现金余额的314%，将大幅提振流动性。

**维持增持。**因运营表现不及预期，我们将18/19/20年的摊薄每股收益预测从人民币0.04/0.10/0.18元下调至0.02/0.07/0.13元，目标价从港币1.06元下调至港币0.79元，对应18/19年27.0/9.0倍市盈率。受油价强势复苏和公司在手订单增加等利好因素推动，宏华未来增长潜力巨大，我们对公司未来发展保持乐观。现价距目标价有14.5%的上涨空间，我们维持增持评级。

Honghua guided that it expects its 1H18 net loss to decrease 60-80% YoY. We attribute the bottom-line improvement to the strong price-led recovery in the oilfield services sector, as well as sound cost controls. However, the stronger performance was weighed by ongoing delays in the sale of its loss-making offshore segment, which is limiting further performance improvement. As such, we revise down our diluted EPS forecast from Rmb0.04 to Rmb0.02 in 18E (turning around a 17A net loss), from Rmb0.10 to Rmb0.07 in 19E (+250.0% YoY) and from Rmb0.18 to Rmb0.13 in 20E (+85.7% YoY). We revise down our target price from HK\$1.06 to HK\$0.79, representing 27.0x 18E PE and 9.0x 19E PE. We are still positive on the company's development potential as amid high oil prices. With 14.5% upside, we maintain our Outperform rating.

**Oil price support.** Given Saudi Arabia's desire for a high IPO valuation for national oil company Saudi Aramco, as well as long-lasting concerns among the Organisation of Petroleum Exporting Countries (Opec) members over the US shale oil threat, we assume Opec production cuts are unlikely to exceed 1m bpd, while the potential Iran shortfall under US sanctions and a collapse in Venezuelan production may exceed 1m bpd. As such, Brent futures remain above US\$75/bbl, having steadily approached US\$80/bbl in early July. High oil prices drive a recovery in upstream Capex, facilitating Honghua's order inflow. Honghua received another US\$53m order for drilling rigs in June 2018, equivalent to 81% of its land drilling rig segment revenue in 2017.

**A delay in sales.** Due to prolonged negotiations with potential buyers, we would expect the sale of Honghua's loss-making offshore segment to close by end-18E, which is longer than our previous expectation. As such, given the company's Rmb100m operating loss in 17A and related impairments booked in 17A, we increase our loss forecast for the offshore business to Rmb100m in 18E. Despite increasing short-term losses, we expect the strategic sale of the business will benefit Honghua in the long-run, as removing a substantial (33%) proportion of the firm's overall operating loss in 17A, and boosting its cash position, with cash received representing 314% of its end-2016 cash balance.

**Maintain Outperform.** With slow progress in the firm's sale of its loss-making offshore segment, we revise down our diluted EPS forecasts from Rmb0.04 to Rmb0.02 in 18E, from Rmb0.10 to Rmb0.07 in 19E (+250% YoY), and from Rmb0.18 to Rmb0.13 in 20E (+86% YoY). We revise down our target price from HK\$1.06 to HK\$0.79, representing 27.0x 18E PE and 9.0x 19E PE. However, we are still positive on the firm's growth outlook on the back of recovering oil prices and strong order inflow. With 14.5% upside, we maintain our Outperform rating.

## Appendix

### Consolidated Income Statement

Rmbm	2016	2017	2018E	2019E	2020E
<b>Revenue</b>	2,148	2,176	4,100	5,100	6,300
Cost of Sales	(1,790)	(1,541)	(2,990)	(3,570)	(4,308)
Gross Profit	358	635	1,110	1,530	1,992
Other Income	136	49	85	90	95
Selling expenses	(370)	(233)	(332)	(459)	(567)
Administrative expenses	(589)	(555)	(601)	(601)	(601)
EBITDA	(238)	190	489	744	1,169
EBIT	(465)	(103)	262	560	919
Finance Costs	(77)	(214)	(130)	(160)	(182)
<b>Profit before tax</b>	(543)	(347)	135	403	740
Income tax expense	25	(49)	(20)	(61)	(111)
Minority interests	(92)	(844)	(2)	(10)	(19)
<b>Profit for the year</b>	(610)	(1,239)	113	333	610

Source: Company data, SWS Research

### Consolidated Cash Flow Statement

Rmbm	2016	2017	2018E	2019E	2020E
<b>Profit before taxation</b>	(696)	(347)	135	403	740
Plus: Depr. and amortisation	295	293	227	184	250
Finance cost	256	240	190	225	252
Losses from investments	0	0	0	0	0
Change in working capital	1,426	1,171	(446)	(453)	(440)
Others	(1,059)	(860)	2,065	(102)	414
<b>CF from operating activities</b>	222	498	2,171	257	1,217
Capex	(135)	(104)	(197)	(245)	(400)
Other CF from investing activities	178	(219)	(121)	(102)	10
<b>CF from investing activities</b>	43	(323)	(318)	(347)	(390)
Equity financing	0	0	0	0	0
Net change in liabilities	(5,771)	(3,837)	(2,895)	(2,172)	(2,072)
Dividend and interest paid	(235)	(240)	(190)	(225)	(252)
Other CF from financing activities	5,322	3,727	2,440	3,130	2,932
<b>CF from financing activities</b>	(684)	(350)	(645)	733	608
<b>Net cash flow</b>	(419)	(175)	1,208	643	1,436
FCFF	87	393	1,975	12	817
FCFE	(2,809)	(1,807)	(125)	(1,988)	(1,183)

Source: Company data, SWS Research

**Consolidated Balance Sheet**

Rmbm	2016	2017	2018E	2019E	2020E
<b>Current Assets</b>	<b>6,852</b>	<b>7,732</b>	<b>7,793</b>	<b>8,998</b>	<b>11,481</b>
Bank balances and cash	544	1,100	2,279	2,911	4,261
Trade and other receivables	3,431	2,560	2,870	3,315	4,095
Inventories	2,116	1,816	1,952	1,960	2,289
Other current assets	760	2,256	692	812	836
<b>Non-current Assets</b>	<b>4,416</b>	<b>2,334</b>	<b>3,364</b>	<b>3,787</b>	<b>3,004</b>
PP&E	2,794	1,516	1,744	2,132	2,137
Intangible and other assets	231	147	173	161	147
Other non-current assets	1,391	671	1,446	1,494	720
<b>Total Assets</b>	<b>11,268</b>	<b>10,067</b>	<b>11,157</b>	<b>12,785</b>	<b>14,485</b>
<b>Current Liabilities</b>	<b>5,023</b>	<b>3,939</b>	<b>4,511</b>	<b>5,426</b>	<b>6,326</b>
Borrowings	2,213	1,434	1,500	2,400	2,800
Trade and other payables	2,678	1,761	2,841	2,856	3,446
Other current liabilities	132	743	170	170	80
Long term borrowings	2,162	1,950	2,330	2,630	2,830
<b>Total Liabilities</b>	<b>7,184</b>	<b>5,889</b>	<b>6,841</b>	<b>8,056</b>	<b>9,156</b>
Shareholder Equity	4,083	4,178	4,316	4,728	5,329
Share Capital	301	488	434	434	434
Reserves	3,598	3,523	3,635	3,937	4,454
Minority Interests	185	167	246	357	441
<b>Total Liabilities and equity</b>	<b>11,268</b>	<b>10,067</b>	<b>11,156</b>	<b>12,784</b>	<b>14,485</b>

Source: Company data, SWS Research

### Key Financial Ratios

	2016	2017	2018E	2019E	2020E
<b>Ratios per share (Rmbm)</b>					
Earnings per share	(0.19)	(0.26)	0.02	0.07	0.13
Diluted EPS	(0.19)	(0.26)	0.02	0.07	0.13
Operating CF per share	0.07	0.11	0.46	0.05	0.26
Dividend per share	0.00	0.00	0.00	0.00	0.01
Net assets per share	1.28	0.89	0.93	1.02	1.17
<b>Key Operating Ratios (%)</b>					
ROIC	-7.81	-15.61	1.44	3.73	5.91
ROE	-14.36	-30.00	2.65	7.36	12.14
Gross profit margin	-11.08	8.72	11.93	14.59	18.56
Ebitda Margin	-21.65	-4.75	6.40	10.99	14.59
Ebit Margin	16.66	29.19	27.07	30.00	31.62
Growth rate of Revenue(YoY)	-44.45	1.32	88.43	24.39	23.53
Growth rate of Profit(YoY)	-70.67	77.46	74.78	37.84	30.20
Debt-to-asset ratio	61.15	58.50	61.15	62.82	62.67
Turnover rate of net assets	0.53	0.53	0.97	1.13	1.25
Turnover rate of total assets	0.19	0.20	0.39	0.42	0.46
Effective tax rate (%)	4.68	-14.04	15.00	15.00	15.00
Dividend yield (%)	-	-	0.67	1.99	3.65
<b>Valuation Ratios (x)</b>					
PE	(2.90)	(2.10)	23.09	7.82	4.26
PB	0.43	0.62	0.60	0.55	0.48
EV/Sale	2.83	2.79	1.48	1.19	0.96

Source: Company data, SWS Research

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BUY: Share price performance is expected to generate more than 20% upside over a 12-month period.

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