



Company Report: China Hongqiao (01378 HK)

公司报告: 中国宏桥 (01378 HK)

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The Operations of the Company Is Stable, Maintain "Neutral"

公司运营稳定, 维持“中性”评级

- **The 2019 interim results of the Company were lower than market consensus and our estimation, mainly due to higher financial costs.** Total revenue of the Company decreased by 6.5% yoy to RMB 41.43 billion; net profit attributable to shareholders increased by 37.3% yoy to RMB2.78 billion. The significant growth in profit was mainly due to low base the same period last year.
- **Maintain aluminum output assumptions of the Company unchanged.** We expect the Company to produce about 6.0 million tons of primary aluminum in 2019. We expect the Company's production capacity of primary aluminum to remain unchanged in the next 3 years and expect production to be stable.
- **Revise down aluminum price assumptions slightly due to weak consumption demand.** We revise down 2019 average annual aluminum price assumptions to US\$1,820/t. We expect aluminum price to be flat or rebound slightly in 2020 and the average annual aluminum price to be around US\$1,850/t-US\$1,950/t.
- **Maintain production cost assumptions of the Company unchanged.** We expect the Company's production costs of primary aluminum to be stable in the 2nd half of 2019.
- **Revise down TP to HK\$4.65 and maintain "Neutral".**
- 公司 2019 年中期业绩差于市场一致预期和我们的估计, 主要是由于更高的财务成本。公司收入同比减少 6.5% 至人民币 414.3 亿元, 股东净利同比增加 37.3% 至人民币 27.8 亿元。利润的显著增长主要是由于去年同期的低基数。
- **维持公司铝产量假设不变。**我们预计公司在 2019 年生产大约 600 万吨原铝。我们预计公司的原铝产量在未来 3 年保持不变且生产稳定。
- **由于消费需求疲弱小幅下调铝价假设。**我们将 2019 年铝价年均价假设下调至 1,820 美元/吨。我们预计铝价在 2020 年将持平或小幅反弹, 全年均价在 1,850 美元/吨- 1,950 美元/吨。
- **维持公司生产成本假设不变。**我们预计公司原铝的生产成本在 2019 年下半年保持稳定。
- **下调公司目标价至 4.65 港元, 维持“中性”评级。**

Rating:

Neutral
Maintained

评级:

中性 (维持)

6-18m TP 目标价:

HK\$4.65

Revised from 原目标价:

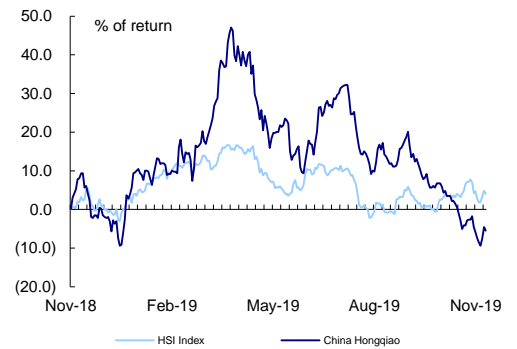
HK\$5.48

Share price 股价:

HK\$4.340

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 %	(8.6)	(18.3)	(5.4)
Rel. % to HS Index 相对恒指变动 %	(9.3)	(20.8)	(9.5)
Avg. Share price(HK\$) 平均股价 (港元)	4.5	4.9	5.2

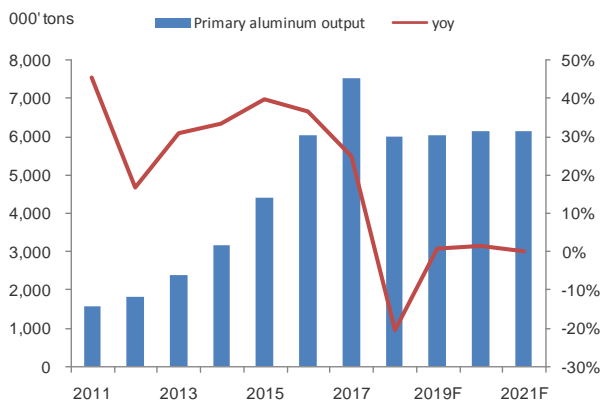
Source: Bloomberg, Guotai Junan International.

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)	(%)	(%)
2017A	97,942	5,130	0.699	(27.2)	5.2	7.318	0.5	0.200	5.5	10.7
2018A	90,195	5,407	0.622	(11.0)	6.1	7.200	0.5	0.240	6.3	9.7
2019F	84,478	5,905	0.679	9.2	5.8	7.679	0.5	0.204	5.2	9.5
2020F	90,251	8,064	0.927	36.5	4.2	8.355	0.5	0.278	7.1	12.1
2021F	90,875	8,567	0.985	6.3	4.0	9.073	0.4	0.296	7.6	11.8
Shares in issue (m) 总股数 (m)				8,696.9	Major shareholder 大股东					Zhang Bo 70.0%
Market cap. (HK\$ m) 市值 (HK\$ m)				37,744.5	Free float (%) 自由流通比率 (%)					30.0%
3 month average vol. 3 个月平均成交股数 ('000)				4,157.8	FY19 Net gearing (%) FY19 净负债/股东资金 (%)					64.2
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				6.850 / 4.080	FY19 Est. NAV (HK\$) FY19 每股估值 (港元)					8.2

Source: the Company, Guotai Junan International.

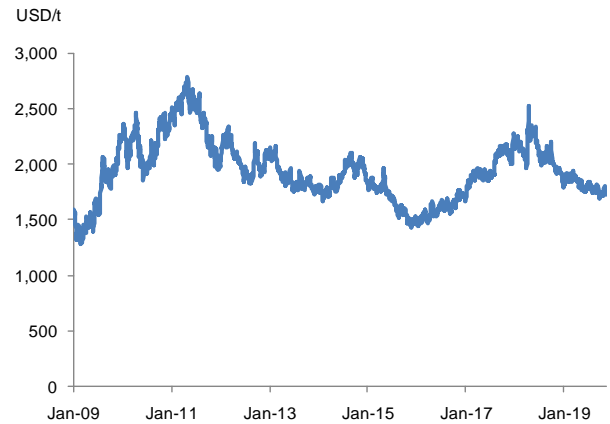
The 2019 interim results of China Hongqiao (the "Company") were lower than market consensus and our estimation, mainly due to higher financial costs. Total revenue of the Company decreased by 6.5% yoy to RMB41.43 billion; net profit attributable to shareholders increased by 37.3% yoy to RMB2.78 billion. The significant growth in profit was mainly due to low base the same period last year. The production of the Company was stable and the average production costs of primary aluminum decreased due to lower electricity costs. The output of primary aluminum decreased by 10.3% yoy to 2.86 million tons, generally in line with our estimation. The decline of primary aluminum output was mainly attributed to production constraint during heating season and production line upgrade. Total sale of aluminum products decreased by 13.9% yoy to 2.53 million tons, total sale of alumina increased by 32.2% to 2.41 million tons. Average LME aluminum price decrease by 16.3% yoy to US\$1,849/t in 1H19, but average domestic aluminum price only decreased by 5.6% yoy to RMB13,786/t. The total gross margin of the Company was up to 3.7 pts to 18.4% in the 1st half of 2019.

Figure-1: Primary aluminum output of China Hongqiao



Source: the Company, Guotai Junan International.

Figure-2: Aluminum price



Source: Bloomberg, Guotai Junan International.

Maintain output assumptions of the Company unchanged. We expect the Company to produce about 6.0 million tons of primary aluminum in 2019. We expect the Company's production capacity of primary aluminum to remain at the current level in the next 3 years. The Company's primary aluminum production capacity experienced violent fluctuations over the past 8 years. 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, the policy environment thoroughly changed in 2017. The Chinese government strongly executed policy on capacity cuts and deleveraging, and the Company was required to shut down 2.68 million tons of production capacity. Since then, new production capacity of primary aluminum will not be easily approved by the government under the new policy environment. In 2018, China's aluminum production capacity expansion was effectively curbed and total primary aluminum output even declined slightly. 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. The Company operates 6.46 million tons of production capacity, which was all filed properly in accordance with relevant regulations. We expect total production capacity of the Company to remain unchanged and expect the Company to produce 6.00 million tons of primary aluminum in 2019 considering production constraints during winter seasons. We expect the output of primary aluminum of the Company to be stable in the future. The production of the Company was stable and we maintain output assumptions of the Company unchanged.

Revise down aluminum price assumptions slightly due to weak consumption demand. We expect aluminum prices to be weighed by weak consumption demand as the trade war between China and the U.S. intensifies. Although supply-side fundamentals of aluminum did not change, global aluminum demand will be negatively impacted by global economic slowdown. China's aluminum production capacity expansion slowed greatly and its aluminum output even declined in 2018 due to the new policy. We expect the supply side of the global aluminum industry to remain stable as China did not launch any new supply-side reform policies or production capacity cut policies in 2019. However, global aluminum demand has been hit by the trade conflict caused by the U.S. and the global economy is expected to slow down in 2019. Aluminum price has been weighed by weak demand since the beginning of 2019 and declined consistently year to date. Such decline was exacerbated in the 3rd quarter and aluminum price even dropped below the level of US\$1,800/t. We believe that global aluminum consumption demand will continue to be hit by a lousy global economy in the rest of 2019 and such condition may persist into 2020, hence aluminum price is expected to remain under pressure. However, we believe production costs will support aluminum price as high-cost production capacity will be wiped out if aluminum price drops below production costs. We expect aluminum price to fluctuate at

the level of US\$1,700/t-US\$2,200/t in 2020. We revise down 2019 average annual aluminum price assumptions to US\$1,820/t. We expect aluminum price to be flat or rebound slightly in 2020 and the average annual aluminum price to be around US\$1,850/t-US\$1,950/t.

Maintain aluminum production costs assumptions unchanged. We expect the Company's production costs of primary aluminum to be stable in the 2nd half of 2019. The production costs of primary aluminum of the Company increased greatly in 2018 due to the rise in electricity costs. China Hongqiao used to hold great competitive advantages in production costs against other aluminum producers due to its unique operation model, especially high self-sufficient ratio of electricity with significantly lower costs. Although its unique operation model remains unchanged, production costs of self-generated electricity surged as the government will impose more tax on self-constructed power stations. On September 17th, 2018, the Shandong Provincial Government released regulation imposing tax on self-constructed power stations of RMB0.1016/kwh. The new regulation will significantly increase power costs to those companies that own self-constructed power stations. China Hongqiao relies on more than 85% of its power supply from its self-constructed power plants. We witnessed significant rise in the production costs of primary aluminum of the Company in 2018. However, we believe outside environments to be stable in 2019 and expect the Company's production costs of primary aluminum to be stable. The Company still holds great production costs advantages due to high self-sufficiency ratio of alumina, close geographical proximity to upstream suppliers and downstream customers, and advanced manufacturing technology which has lead to low power consumption level for each ton of primary aluminum produced. As market conditions did not change much, we maintain aluminum production costs assumptions unchanged.

Revise down TP to HK\$4.65 and maintain "Neutral". China Hongqiao is a large integrated electricity-aluminum manufacturer with significant production cost advantages in the industry. Although the new regulation significantly raised power costs of the Company, we believe that the Company still holds great competitive advantages due to its unique operation model. The Company holds sufficient supply of alumina and we believe its power costs will still be lower than its counterparts, which will still enhance its competitive advantages. We expect the output of aluminum of the Company to remain stable at the level of about 6 million tons in 2019-2021. We expect the expansion period of the Company to come to an end, hence capital expenditure of the Company is also expected to drop greatly starting 2018 and the financial statements of the Company are expected to improve significantly. We maintain aluminum output assumptions of the Company unchanged. We revise down 2019 average annual aluminum price assumptions to US\$1,820/t. We expect aluminum price to be flat or rebound slightly in 2020 and the average annual aluminum price to be around US\$1,850/t-US\$1,950/t. We expect production costs of primary aluminum to be stable in the 2nd half 2019. However, the Company still confronts uncertainty surrounding policies, mainly regarding compensatory payment of its self-constructed power station. We revise down the TP of the Company to HK\$4.65 due to lower EPS estimations, which represents 6.0x FY19 PE and 4.5x FY20 PE. We believe aluminum price is not expected to decline further as it is closing to industrial production costs level, so we maintain the investment rating of the Company at "Neutral".

Table-1: Peers Comparison

Company	Stock Code	Currency	Last price	PE (fiscal year)				PB (fiscal year)				ROE(%)
				18A	19F	20F	21F	18A	19F	20F	21F	19F
International Listed companies												
Alcoa Inc	AA US	USD	20.57	16.9	n.a.	23.5	15.6	0.7	0.9	0.9	0.8	(8.4)
Norsk Hydro Asa	NHY NO	NOK	32.25	15.5	37.3	14.2	10.4	0.8	0.8	0.8	0.7	0.9
Aluar Aluminio	ALUA AR	ARS	32.85	44.5	13.6	13.9	n.a.	3.4	3.3	n.a.	n.a.	24.7
Hindalco Industries Ltd	HNDL IN	INR	191.85	7.0	7.8	9.1	8.3	0.8	0.7	0.7	0.7	9.8
National Aluminium Co Ltd	NACL IN	INR	42.20	6.1	4.7	10.4	10.4	0.8	0.8	0.8	0.8	16.5
Simple Average				18.0	15.8	14.2	11.2	1.3	1.3	0.8	0.7	8.7
Weighted Average				14.9	21.6	14.2	10.8	1.0	1.0	0.8	0.7	4.6
PRC listed companies												
Aluminum Corp Of China Ltd-A	601600 CH	CNY	3.31	75.2	42.4	28.8	22.1	1.0	1.0	1.0	0.9	2.4
Shandong Nanshan Aluminum-A	600219 CH	CNY	2.10	12.8	15.3	12.7	10.7	0.7	0.7	0.6	0.6	4.2
Henan Shenhua Coal & Power-A	000933 CH	CNY	4.63	35.6	24.8	13.9	10.2	1.4	1.3	1.2	1.0	5.3
Simple Average				41.2	27.5	18.5	14.3	1.0	1.0	0.9	0.8	4.0
Weighted Average				52.9	32.7	22.5	17.5	1.0	0.9	0.9	0.8	3.2
HK listed companies												
China Hongqiao Group Ltd	1378 HK	HKD	4.34	5.9	5.6	4.4	3.7	0.6	0.5	0.5	0.4	9.7
Aluminum Corp Of China Ltd-H	2600 HK	HKD	2.37	45.4	27.9	17.8	11.7	0.6	0.6	0.6	0.6	2.1
United Co Rusal Plc	486 HK	HKD	3.46	3.9	5.2	4.1	3.8	1.3	1.0	0.8	0.7	19.9
Simple Average				18.4	12.9	8.8	6.4	0.8	0.7	0.6	0.6	10.6
Weighted Average				17.3	12.1	8.3	6.0	0.7	0.6	0.6	0.5	8.5

Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement						Balance Sheet					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F	Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F
Total Revenue	97,942	90,195	84,478	90,251	90,875	PPE	84,043	76,361	76,061	74,436	72,811
COGS	(81,562)	(74,794)	(71,206)	(74,121)	(74,385)	Prepaid lease payments	3,807	4,915	4,178	3,551	3,018
Gross profit	16,380	15,401	13,272	16,130	16,491	Deferred tax assets	1,785	1,866	1,403	1,684	1,651
Distribution & Selling expenses	(270)	(371)	(296)	(316)	(318)	Others	3,198	3,785	8,795	8,842	9,348
Administrative expenses	(2,083)	(3,867)	(2,534)	(2,708)	(2,726)	Total Non-current Assets	92,833	86,927	90,437	88,513	86,828
Operating Profit	14,027	11,162	10,442	13,107	13,446	Cash & Cash Equivalents	21,948	45,380	22,809	22,563	22,719
Other gains and losses	(2,829)	1,607	1,525	1,465	1,406	Inventories	15,585	19,806	15,206	16,245	16,358
Finance costs	(4,081)	(4,433)	(3,514)	(3,151)	(2,662)	Trade and other receivables	14,124	18,477	17,740	18,682	18,629
Profit Before Tax	7,117	8,336	8,454	11,420	12,190	Prepayments and other receivables	12,932	4,880	10,137	10,830	10,451
Income Tax	(1,789)	(2,549)	(2,113)	(2,855)	(3,048)	Others	1,263	1,256	1,068	908	772
profit After Tax	5,328	5,786	6,340	8,565	9,143	Total Current Assets	65,852	89,800	66,961	69,228	68,928
Non-controlling Interest	(198)	(379)	(436)	(501)	(576)	Total Assets	158,685	176,727	157,398	157,741	155,756
Shareholders' Profit / Loss	5,130	5,407	5,905	8,064	8,567	Bank and other loans	12,529	22,934	23,371	22,758	20,184
Basic EPS	0.699	0.622	0.679	0.927	0.985	Trade and Other Payables	32,408	28,502	23,415	23,884	24,612
						Others	8,376	3,233	1,534	1,611	1,691
						Total Current Liabilities	55,271	57,748	48,320	48,253	46,487
						Median Note	36,272	41,077	36,000	32,000	27,000
						Bank and other borrowings	10,526	11,264	5,000	3,500	2,000
						Others	2,879	4,019	1,293	1,328	1,365
						Total Non-current Liabilities	49,677	56,360	42,293	36,828	30,365
						Total Liabilities	104,947	114,107	90,613	85,082	76,852
						Total Shareholders' Equity	51,520	59,965	63,919	69,564	75,560
						Minority Interest	2,218	2,654	2,866	3,096	3,343
						Total Equity	53,738	62,619	66,785	72,660	78,904
Cash Flow Statement						Financial Ratios					
Year end 31 Dec (RMB m)	2017A	2018A	2019F	2020F	2021F		2017A	2018A	2019F	2020F	2021F
Profit before tax	7,117	8,336	8,454	11,420	12,190	Margin:					
Adjust for depre.&amort.	7,781	7,176	5,508	5,475	5,425	Gross margin	16.7%	17.1%	15.7%	17.9%	18.1%
Change in WC	6,985	(7,613)	(5,141)	(2,204)	1,047	Net margin	5.2%	6.0%	7.0%	8.9%	9.4%
Income tax paid	(2,686)	(2,167)	(2,113)	(2,855)	(3,048)	ROE	10.7%	9.7%	9.5%	12.1%	11.8%
Others	13,141	3,628	(10,240)	2,777	2,327	ROA	3.2%	3.1%	3.8%	5.1%	5.5%
Cash from Operating Activities	32,338	9,360	(3,532)	14,614	17,942	Free CF	23,512	5,191	-7,532	10,764	14,142
Capital expenditure	(8,826)	(4,169)	(4,000)	(3,850)	(3,800)	Net gearing	75.2%	51.4%	64.2%	51.2%	34.9%
Others	(10,771)	9,618	(263)	(202)	(380)						
Cash from Investing Activities	(19,597)	5,449	(4,263)	(4,052)	(4,180)						
Share issue	4,669	5,121	320	0	0						
Interest paid	(3,994)	(3,920)	(3,514)	(3,151)	(2,662)						
Dividend paid	0	(4,863)	(1,771)	(2,419)	(2,570)						
Net cash from borrowing	1,103	10,070	(10,904)	(6,113)	(9,075)						
Others	0	1,367	1,093	875	700						
Cash from Financing Activities	(3,920)	8,603	(14,776)	(10,809)	(13,606)						
Net Changes in Cash	8,821	23,412	(22,571)	(246)	156						
Cash at Beg of Year	13,142	21,948	45,380	22,809	22,563						
Foreign exchange rate changes	(14)	21	0	0	0						
Cash at End of Year	21,948	45,380	22,809	22,563	22,719						

Source: the Company, 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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