

Aluminum Corp. of China (2600.HK)

Earnings Review: 1H18 below expectations, sector outlook remains positive

Buy

2600.HK	12m Price Target: HK\$5.60	Price: HK\$3.04	Upside: 84.2%
601600.SS	12m Price Target: Rmb6.00	Price: Rmb3.64	Upside: 64.8%

Chalco 1H18A net profit (after perpetual bond) was Rmb794mn or EPS of Rmb0.048/sh, up 4% YoY. Excluding government subsidy (Rmb593mn) and hedging gain (Rmb70mn), recurring NP was Rmb276mn, lower than our expectation and Bloomberg consensus due to lower trading revenue and higher other cost from alumina and aluminum segments.

Alumina sales volume (excluding chemical grade) was 2.11mnt in 1H18A under our estimates, 6% lower YoY. Realized ASP for alumina was Rmb2,827/t (VAT included) in 1H18, up 7% yoy and mostly inline with our expectation. Aluminum sales volume was 2.06mnt, up 24% yoy, higher than our expectation. Realized ASP for aluminum was Rmb12,321/t, mostly inline. Unit production cost increased by 9-10% yoy for alumina and aluminum mainly due to higher raw material prices, mostly in line with our expectation. Operating cash flow was solid at Rmb6.7bn, up 26% YoY. Net gearing declined to 159% versus 191% at the end of 2017. This is mainly due to Chalco's booking of "capital reserve" by including the proposed new A-share issuance for acquiring minority assets based on the acquisition agreements signed in January 2018 and the minority asset owners have effectively surrendered their minority interest.

We maintain our positive view on the Chinese aluminum sector, driven by supply side improvement on the back of a pause in new line approvals. We see a more balanced outlook for alumina, yet with potential upside risks to alumina prices given "expanded 2+26" regions hold 24% more share of alumina output versus the "2+26" region. We revised down our SHFE-aluminum price assumption by 6% to US\$0.86/lb (or 2% to Rmb14,606/t) for 2018E, down 10% to US\$0.87/lb (or 3% to Rmb15,045/t) in 2019E, down 6% to

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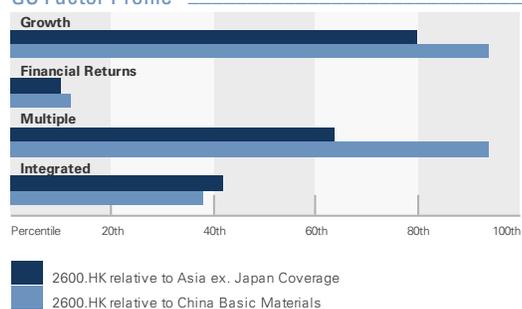
Key Data

Market cap: HK\$51.7bn / \$6.6bn
Enterprise value: HK\$154.4bn / \$19.7bn
3m ADTV: HK\$101.9mn / \$13.0mn
China
China Basic Materials
M&A Rank: 3

GS Forecast

	12/17	12/18E	12/19E	12/20E
Revenue (Rmb mn) New	180,080.8	168,334.8	175,164.5	181,099.3
Revenue (Rmb mn) Old	180,080.8	185,254.1	193,345.0	193,728.2
EBITDA (Rmb mn)	14,477.1	13,829.9	13,600.1	16,761.1
EPS (Rmb) New	0.09	0.09	0.23	0.35
EPS (Rmb) Old	0.09	0.14	0.28	0.33
P/E (X)	44.5	28.6	11.6	7.5
P/B (X)	1.6	0.8	0.8	0.7
Dividend yield (%)	0.0	0.0	0.0	0.0
CROCI (%)	6.0	5.6	5.0	5.9
	6/18	12/18E	6/19E	12/19E
EPS (Rmb)	0.05	0.04	0.13	0.10

GS Factor Profile



Source: Company data, Goldman Sachs Research estimates. See disclosures for details.

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Buy

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Rating since Apr 27, 2018

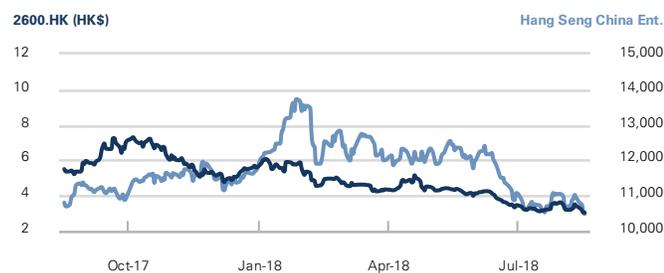
Ratios & Valuation

	12/17	12/18E	12/19E	12/20E
P/E (X)	44.5	28.6	11.6	7.5
P/B (X)	1.6	0.8	0.8	0.7
FCF yield (%)	3.6	(0.7)	0.5	3.7
EV/EBITDA (X)	10.1	9.8	10.0	8.1
CROCI (%)	6.0	5.6	5.0	5.9
ROE (%)	3.6	3.4	7.0	9.9
Net debt/equity (%)	114.9	78.0	72.9	64.0
Interest cover (X)	1.5	1.6	2.3	3.0
Days inventory outst, sales	38.8	41.5	37.7	37.1
Receivable days	15.6	16.8	16.0	16.0
Days payable outstanding	26.1	28.1	27.2	27.7
DuPont ROE (%)	2.1	1.9	4.6	6.4
Turnover (X)	0.9	0.8	0.8	0.8
Leverage (X)	3.1	2.5	2.4	2.3

Growth & Margins (%)

	12/17	12/18E	12/19E	12/20E
Total revenue growth	24.9	(6.5)	4.1	3.4
EBITDA growth	15.3	(4.5)	(1.7)	23.2
EPS growth	259.2	1.0	146.5	53.9
DPS growth	NM	NM	NM	NM
EBIT margin	4.2	4.7	6.1	7.7
EBITDA margin	8.0	8.2	7.8	9.3
Net income margin	0.8	0.9	2.2	3.3

Price Performance



	3m	6m	12m
Absolute	(30.1)%	(38.5)%	(43.6)%
Rel. to the Hang Seng China Ent.	(17.0)%	(26.4)%	(41.8)%

Source: FactSet. Price as of 16 Aug 2018 close.

Income Statement (Rmb mn)

	12/17	12/18E	12/19E	12/20E
Total revenue	180,080.8	168,334.8	175,164.5	181,099.3
Cost of goods sold	(165,675.0)	(154,932.0)	(157,987.1)	(160,652.6)
SG&A	(6,910.7)	(6,275.7)	(6,529.6)	(6,634.3)
R&D	(494.6)	(278.1)	(290.5)	(294.1)
Other operating inc./exp.)	646.5	1,072.5	400.0	400.0
EBITDA	14,477.1	13,829.9	13,600.1	16,761.1
Depreciation & amortization	(6,830.2)	(5,908.4)	(2,842.8)	(2,842.8)
EBIT	7,646.9	7,921.5	10,757.3	13,918.4
Net interest inc./exp.)	(4,483.6)	(4,164.2)	(3,839.5)	(3,782.5)
Income/(loss) from associates	(157.1)	(243.9)	0.0	0.0
Pre-tax profit	3,006.2	3,513.4	6,917.8	10,135.8
Provision for taxes	(642.3)	(884.8)	(1,729.5)	(2,534.0)
Minority interest	(985.5)	(1,055.6)	(1,271.1)	(1,573.8)
Preferred dividends	-	-	-	-
Net inc. (pre-exceptionals)	1,378.4	1,573.0	3,917.3	6,028.1
Post-tax exceptionals	-	-	-	-
Net inc. (post-exceptionals)	1,378.4	1,573.0	3,917.3	6,028.1
EPS (basic, pre-exception) (Rmb)	0.09	0.09	0.23	0.35
EPS (diluted, pre-exception) (Rmb)	0.09	0.09	0.23	0.35
EPS (basic, post-exception) (Rmb)	0.09	0.09	0.23	0.35
EPS (diluted, post-exception) (Rmb)	0.09	0.09	0.23	0.35
DPS (Rmb)	-	0.00	0.00	-
Div. payout ratio (%)	0.0	0.0	0.0	0.0

Balance Sheet (Rmb mn)

	12/17	12/18E	12/19E	12/20E
Cash & cash equivalents	27,750.7	27,793.9	28,921.5	29,901.4
Accounts receivable	8,026.2	7,502.7	7,807.1	8,071.6
Inventory	20,346.7	17,899.0	18,251.9	18,559.8
Other current assets	12,225.7	12,225.7	12,225.7	12,225.7
Total current assets	68,349.3	65,421.2	67,206.2	68,758.6
Net PP&E	96,096.7	100,453.3	105,625.5	110,797.8
Net intangibles	10,653.2	10,638.2	10,623.2	10,608.2
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	25,047.4	25,047.4	25,047.4	25,047.4
Total assets	200,146.6	201,560.1	208,502.3	215,211.9
Accounts payable	12,322.0	11,518.3	11,985.6	12,391.7
Short-term debt	62,752.6	55,348.3	55,797.1	54,715.8
Other current liabilities	14,902.4	13,945.4	14,495.0	14,972.2
Total current liabilities	89,976.9	80,812.0	82,277.7	82,079.7
Long-term debt	40,289.7	35,535.9	35,824.0	35,129.8
Other long-term liabilities	4,366.1	4,366.1	4,366.1	4,366.1
Total long-term liabilities	44,655.8	39,902.0	40,190.2	39,495.9
Total liabilities	134,632.7	120,714.0	122,467.8	121,575.6
Preferred shares	-	-	-	-
Total common equity	39,478.5	53,755.1	57,672.4	63,700.5
Minority interest	26,035.4	27,091.0	28,362.1	29,935.8
Total liabilities & equity	200,146.6	201,560.1	208,502.3	215,211.9
Gross cash invested (ex cash)	203,834.2	212,858.6	220,484.1	228,158.2
Net debt, adjusted	75,291.6	63,090.3	62,699.6	59,944.1
Average capital employed	139,280.3	142,370.9	146,335.3	151,157.3
BVPS (Rmb)	2.65	3.19	3.39	3.74

Cash Flow (Rmb mn)

	12/17	12/18E	12/19E	12/20E
Net income	1,378.4	1,573.0	3,917.3	6,028.1
D&A add-back	6,830.2	5,908.4	2,842.8	2,842.8
Minority interest add-back	985.5	1,055.6	1,271.1	1,573.8
Net (inc)/dec working capital	4,643.3	1,210.6	359.5	310.9
Other operating cash flow	(709.6)	-	-	-
Cash flow from operations	13,127.8	9,747.6	8,390.7	10,755.5
Capital expenditures	(10,021.0)	(10,250.0)	(8,000.0)	(8,000.0)
Acquisitions	-	-	-	-
Divestitures	-	-	-	-
Others	2,887.6	-	-	-
Cash flow from investing	(7,133.4)	(10,250.0)	(8,000.0)	(8,000.0)
Dividends paid (common & pref)	-	-	0.0	-
Inc/(dec) in debt	(2,739.9)	(12,158.1)	737.0	(1,775.6)
Other financing cash flows	682.4	12,703.7	0.0	0.0
Cash flow from financing	(2,057.4)	545.6	737.0	(1,775.6)
Total cash flow	3,937.0	43.2	1,127.6	979.9
Free cash flow	3,106.8	(502.4)	390.7	2,755.5

Source: Company data, Goldman Sachs Research estimates.

US\$0.90/lb (or flat in Rmb15,654/t) in 2020E, to reflect the slower pace of improvement due to weaker demand, and new USDCNY exchange rate from 6.3 to 6.8. Our new price assumption implies a spread of Rmb2,600/t for 2019E (from Rmb3,000/t), but the same Rmb3,000/t spread for 2020E.

We revise down EPS by 33% for 2018E and 18% for 2019E to reflect the lower aluminum spread in 2019E, higher other cost in alumina/aluminum segments from 1H18 results and the impact of new shares from the equity exchange agreement. With benefits from both aluminum and alumina price improvement, we expect Chalco to deliver ROE of 6.8% in 2019E, from 3.3% in 2017 and 3.1% in 2018E. For every Rmb500/t increase in alumina price, we estimate earnings would improve by 44% (EPS of Rmb0.09/sh) in 2019E, assuming pass-through to aluminum prices. For every US\$0.05/lb increase in aluminum price, we would expect earnings to improve by 66% in 2019E. Our new 12-month target price for Chalco-H is HK\$5.6 (from HK\$5.9) and Rmb 6.0 for Chalco-A (from Rmb 6.5). Our target price methodology remains unchanged, based on historical P/B vs. ROE correlation - 2019E P/B of 1.4x/1.8x on ROE of 6.8% (from 1.6x/2.1x with ROE at 9.4%) for H/A. We maintain our Buy rating on both Chalco-H and Chalco-A.

Key risks include: 1) Aluminum and alumina pricing, which are driven by supply-demand: aluminum and alumina price will directly affect Chalco's profit. 2) Progress of restructuring plan: if the restructuring plan does not get government approval or sees a significant delay on timetable, minority holdings in certain Chalco subsidiaries will continue to be at a high level. 3) Execution of supply-side reforms on shutting down illegal capacity: if the execution is not successful or the shut-down capacity resumes production, it will increase market supply and be negative to supply/demand balance.

Exhibit 1: 1H18 results summary - Chalco

		1H18A	1H17A	YoY(%)	1H18E	A vs E(%)
Turnover	Rmb mn	82,056	91,421	-10%	91,871	-11%
COGS	Rmb mn	(75,809)	(85,216)	-11%	(84,456)	-10%
Gross profit	Rmb mn	6,248	6,206	1%	7,415	-16%
SG&A	Rmb mn	(2,972)	(2,867)	4%	(2,846)	4%
Others	Rmb mn	937	212	342%	(23)	n.a.
EBIT	Rmb mn	4,212	3,551	19%	4,546	-7%
EBIT-recurring	Rmb mn	3,498	2,943	19%	4,546	-23%
Share of profit of JV	Rmb mn	(122)	96	-227%	226	n.a.
Finance costs	Rmb mn	(2,161)	(2,068)	5%	(2,249)	-4%
Profit before taxes	Rmb mn	1,929	1,579	22%	2,523	-24%
Income taxes	Rmb mn	(568)	(348)	63%	(631)	-10%
Minorities	Rmb mn	(512)	(494)	4%	(895)	-43%
Net profit	Rmb mn	848	737	15%	997	-15%
Interest to perpetual	Rmb mn	(55)	(55)	0%	(55)	-1%
NP-post PPB	Rmb mn	794	682	16%	942	-16%
One offs (bf tax)	Rmb mn	744	240	210%	-	n.a.
recurring NP-post PPB	Rmb mn	276	509	-46%	942	-71%
EPS	Rmb/sh	0.048	0.046	4%	0.057	-16%
EPS-recurring	Rmb/sh	0.017	0.034	-52%	0.057	-71%
Alumina output	mnt	8.14	7.78	5%	7.83	4%
Al output	mnt	2.06	1.66	24%	1.92	7%
Coal output	mnt	5.13	5.02	2%	5.00	3%
Al price - LME	US\$/lb	1.00	0.85	18%	1.04	-4%
Al price - SHFE	US\$/lb	0.88	0.77	13%	0.90	-2%
ASP-alumina	Rmb/t	2,416	2,257	7%	2,434	-1%
ASP-aluminium	Rmb/t	12,321	11,824	4%	12,502	-1%
Sales-alumina	mnt	2.11	2.24	-6%	2.70	-22%
Sales-aluminium	mnt	2.06	1.66	24%	1.92	7%
Unit COGS-alumina	Rmb/t	2,000	1,820	10%	2,032	-2%
Unit COGS-aluminium	Rmb/t	11,600	10,640	9%	11,428	2%
A/R days	days	21	17	22%		
A/P days	days	35	26	34%		
Inv days	days	52	42	23%		
Net debt*	Rmb bn	81,201	75,292	8%		
Net gearing*	%	159%	191%	-32%		
OCF	Rmb mn	6,742	5,362	26%		
FCF	Rmb mn	6,003	2,489	141%		

Source: Company data, Goldman Sachs Global Investment Research, *number from year-end 2017

Exhibit 2: Key assumptions and financials - Chalco

Key assumptions and financials - CHALCO							
Chalco		2015A	2016A	2017A	2018E	2019E	2020E
Aluminium-LME	US\$/lb	0.76	0.73	0.89	1.01	0.92	0.91
Aluminium-SHFE	US\$/lb	0.76	0.72	0.83	0.86	0.87	0.90
Alumina-Australia FOB	US\$/t	302	252	299	400	350	325
Alumina-China (w VAT)	Rmb/t	2,377	2,016	2,875	2,928	3,000	3,000
Carbon anode (w VAT)	Rmb/t	2,955	2,645	3,873	3,762	3,250	3,500
AI spread-industry	Rmb/t	(426)	2,113	2,519	2,174	2,600	3,000
USD/CNY	x	6.28	6.64	6.91	6.59	6.80	6.80
Volume-alumina total	mnt	15.3	14.5	15.7	16.1	16.1	16.1
Volume-alumina external	mnt	5.1	5.9	4.3	4.5	4.4	3.9
Volume-AI (equity)	mnt	3.4	2.9	3.6	4.1	4.5	4.8
power price	Rmb/kwh	0.282	0.237	0.291	0.294	0.299	0.298
Unit op cost-Alumina	US\$/t	264	226	289	318	308	308
Unit op cost-Aluminium	US\$/lb	0.764	0.595	0.705	0.769	0.720	0.713
Unit EBITDA-alumina	US\$/t	47	34	50	60	69	69
Unit EBITDA-AI	US\$/lb	(0.008)	0.123	0.094	0.083	0.083	0.125
EBIT (recurring)	Rmb mn	(2,323)	3,976	7,921	7,178	10,757	13,918
Alumina	Rmb mn	1,432	368	3,329	3,666	4,696	4,694
Aluminium	Rmb mn	(3,271)	2,584	1,855	1,836	5,605	8,904
Others	Rmb mn	(484)	1,024	2,737	1,677	457	320
EBITDA-recurring	Rmb mn	4,797	10,718	14,751	13,086	13,600	16,761
Net Profit(rpt-bf PPB)	Rmb mn	149	384	1,378	1,573	3,917	6,028
Net Profit(post PPB)	Rmb mn	129	274	1,268	1,463	3,807	5,918
NP(recurring bf PPB)	Rmb/sh	(5,186)	(415)	1,792	1,017	3,917	6,028
EPS	Rmb/sh	0.010	0.026	0.092	0.093	0.230	0.354
EPS-recurring	Rmb/sh	(0.365)	(0.028)	0.120	0.060	0.230	0.354
BV	Rmb/sh	2.811	2.561	2.649	3.191	3.388	3.742
Net debt (incl PPB)	Rmb mn	94,900	92,212	82,951	70,750	70,359	67,603
Operating cash flow	Rmb mn	7,378	11,530	13,128	9,748	8,391	10,755
Investing cash flow	Rmb mn	(2,393)	(4,999)	(7,133)	(10,250)	(8,000)	(8,000)
Free cash flow	Rmb mn	4,985	6,532	5,994	(502)	391	2,755
ROE	%	0.4%	0.7%	3.3%	3.1%	6.8%	9.8%
ROE-recurring	%	0.4%	0.7%	3.3%	3.1%	6.8%	9.8%
ROIC	%	9.0%	3.0%	4.2%	4.1%	5.5%	6.9%
net debt/equity+PPB	%	238%	242%	210%	132%	122%	106%

Source: Company data, Goldman Sachs Global Investment Research

Exhibit 3: Earnings sensitivity - 2018-2019E

Earnings and valuation sensitivity-2018E - H shares									
AI (US\$/lb)	NP-2018E (Rmb mn)			ROE-2018E (%)			Implied P/E-2018E (x)		
	Al2O3 (Rmb/t, w VAT)			Al2O3 (Rmb/t, w VAT)			Al2O3 (Rmb/t, w VAT)		
	2500	3000	3500	2500	3000	3500	2500	3000	3500
0.85	(254)	798	1,766	-0.9%	1.7%	4.1%	(200.7)	64.0	28.9
0.90	914	1,925	2,882	2.0%	4.5%	6.8%	55.8	26.5	17.7
0.95	2,322	3,299	4,242	5.4%	7.8%	9.9%	22.0	15.5	12.0
1.00	3,939	4,890	5,821	9.2%	11.4%	13.5%	13.0	10.4	8.8
Earnings and valuation sensitivity-2019E - H shares									
AI (US\$/lb)	NP-2019E (Rmb mn)			ROE-2019E (%)			Implied P/E-2019E (x)		
	Al2O3 (Rmb/t, w VAT)			Al2O3 (Rmb/t, w VAT)			Al2O3 (Rmb/t, w VAT)		
	2500	3000	3500	2500	3000	3500	2500	3000	3500
0.85	311	1,190	2,016	0.5%	2.6%	4.5%	164.3	42.9	25.3
0.90	1,555	2,394	3,205	3.4%	5.3%	7.2%	32.8	21.3	15.9
0.95	3,054	3,861	4,655	6.8%	8.6%	10.4%	16.7	13.2	11.0
1.00	4,776	5,560	6,337	10.6%	12.3%	13.9%	10.7	9.2	8.1

Source: Company data, Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Trina Chen and Joy Zhang, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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GS Factor Profile

The Goldman Sachs Factor Profile provides investment context for a stock by comparing key attributes to the market (i.e. our coverage universe) and its sector peers. The four key attributes depicted are: Growth, Financial Returns, Multiple (e.g. valuation) and Integrated (a composite of Growth, Financial Returns and Multiple). Growth, Financial Returns and Multiple are calculated by using normalized ranks for specific metrics for each stock. The normalized ranks for the metrics are then averaged and converted into percentiles for the relevant attribute. The precise calculation of each metric may vary depending on the fiscal year, industry and region, but the standard approach is as follows:

Growth is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

Financial Returns and Multiple use the Goldman Sachs analyst forecasts at the fiscal year-end at least three quarters in the future. Growth uses inputs for the fiscal year at least seven quarters in the future compared with the year at least three quarters in the future (on a per-share basis for all metrics).

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M&A Rank

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Quantum

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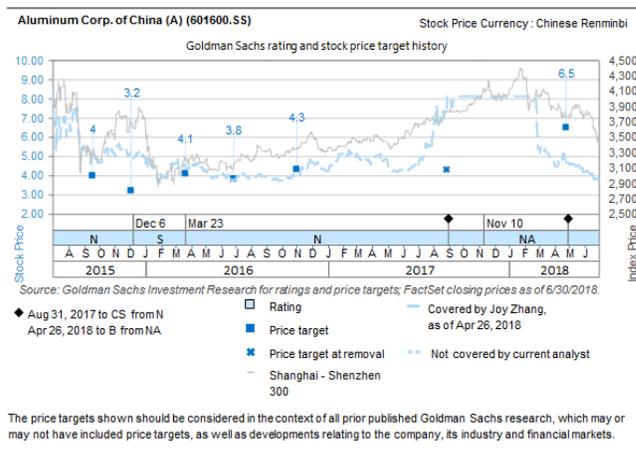
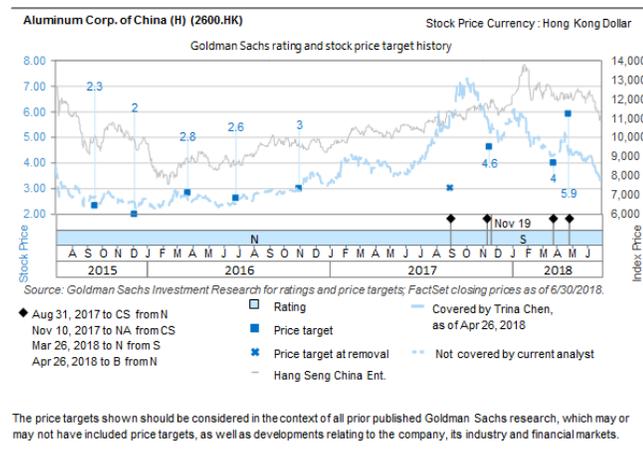
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