

Angang Steel (0347.HK)

Earnings Review: FY18 above expectation, improving margin outlook from current level

0347.HK	12m Price Target: HK\$8.60	Price: HK\$6.29	Upside: 36.7%
000898.SZ	12m Price Target: Rmb7.90	Price: Rmb6.05	Upside: 30.6%

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Angang FY18A recurring NP was Rmb7.8bn, or EPS of Rmb1.074/share, up 15% yoy. The result is 10-13% ahead of our expectation and consensus (IBES), driven by higher volume and lower-than-expected SG&A cost. The company also announced cash dividend of Rmb1.59bn (or Rmb0.220/sh) in 2018A, implies 20% payout ratio, and will issue shares to all shareholders by way of capitalisation of capital reserve, on the basis of three (3) capitalisation shares for every ten (10) existing shares.

Sales volume were 24.1 mnt, up 5% YoY, mostly due to the consolidation of Chaoyang. Unit gross profit was Rmb718/t, up 28% yoy, driven by higher ASP partly offset by higher cost. Unit EBITDA (recurring) was to Rmb619/t or US\$94/t. Specifically, we estimate 4Q18A unit gross profit was Rmb488/t, versus Rmb787/t in 9M18A. Operating cash flow was Rmb8.3bn, up 32% yoy. Net gearing improved to 26% from 38% a year ago, 34% ahead of our expectation. We estimate the implied free-cash-flow yield was 11.1% for 2018A.

We expect Angang to deliver lower unit gross profit in 2019E and 2020E at Rmb545/t and 522/t, respectively, as cost level eases for the industry's marginal cost producers (EAF). Nevertheless, we expect the industry S/D to remain at balance, with high capacity utilization. Our recent China visits suggests better-than-expected 2Q19 demand ahead, and potential tightening environmental related capacity cut, paving the way of improving steel margins from the current level in our view. Valuation remains attractive, with implied P/E at 12X based on earnings at current spot gross profit, at 7X on our estimates.

Key Data

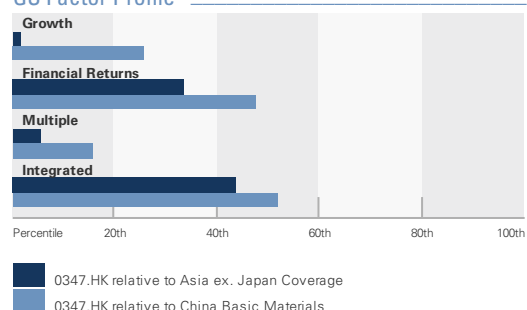
Market cap: HK\$45.5bn / \$5.8bn
Enterprise value: HK\$56.9bn / \$7.2bn
3m ADTV: HK\$61.5mn / \$7.8mn
China
China Basic Materials
M&A Rank: 3
Asia ex. Japan Conviction List

GS Forecast

	12/18	12/19E	12/20E	12/21E
Revenue (Rmb mn) New	103,973.0	105,504.8	102,032.3	101,935.0
Revenue (Rmb mn) Old	101,663.0	97,551.0	95,164.3	–
EBITDA (Rmb mn)	15,168.0	11,534.1	10,993.3	10,945.8
EPS (Rmb) New	1.10	0.71	0.69	0.72
EPS (Rmb) Old	0.98	0.70	0.66	–
P/E (X)	5.7	7.6	7.8	7.5
P/B (X)	0.9	0.7	0.6	0.6
Dividend yield (%)	3.5	2.6	2.6	2.7
CROCI (%)	4.2	8.2	7.3	7.1

	12/18	6/19E	12/19E	6/20E
EPS (Rmb)	0.65	0.27	0.44	0.35

GS Factor Profile



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

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Buy

Buy

Angang Steel (0347.HK)

Rating since Nov 20, 2017

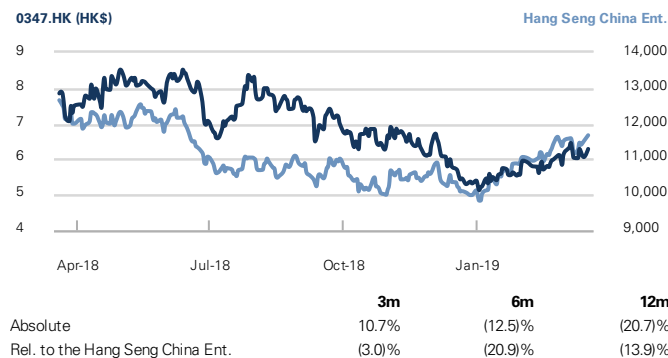
Ratios & Valuation

	12/18	12/19E	12/20E	12/21E
P/E (X)	5.7	7.6	7.8	7.5
P/B (X)	0.9	0.7	0.6	0.6
FCF yield (%)	11.9	14.5	18.6	17.8
EV/EBITDA (X)	3.5	4.2	3.9	3.3
CROCI (%)	4.2	8.2	7.3	7.1
ROE (%)	15.6	9.5	8.6	8.4
Net debt/equity (%)	25.4	16.3	4.8	(4.8)
Interest cover (X)	7.6	8.8	13.4	31.0
Days inventory outst, sales	43.5	46.7	48.8	48.0
Receivable days	38.3	33.6	34.4	33.9
Days payable outstanding	36.7	35.8	36.6	36.0
DuPont ROE (%)	15.2	9.1	8.2	8.0
Turnover (X)	1.2	1.2	1.2	1.2
Leverage (X)	1.7	1.6	1.4	1.4

Growth & Margins (%)

	12/18	12/19E	12/20E	12/21E
Total revenue growth	24.6	1.5	(3.3)	(0.1)
EBITDA growth	49.5	(24.0)	(4.7)	(0.4)
EPS growth	41.9	(35.4)	(2.9)	4.2
DPS growth	(5.3)	(35.4)	(2.9)	4.2
EBIT margin	11.0	7.3	7.0	7.0
EBITDA margin	14.6	10.9	10.8	10.7
Net income margin	7.6	4.9	4.9	5.1

Price Performance



Source: FactSet. Price as of 18 Mar 2019 close.

Income Statement (Rmb mn)

	12/18	12/19E	12/20E	12/21E
Total revenue	103,973.0	105,504.8	102,032.3	101,935.0
Cost of goods sold	(88,126.0)	(93,039.6)	(90,097.3)	(90,046.6)
SG&A	(4,333.0)	(4,512.8)	(4,512.8)	(4,512.8)
R&D	—	—	—	—
Other operating inc./exp.)	159.0	—	—	—
EBITDA	15,168.0	11,534.1	10,993.3	10,945.8
Depreciation & amortization	(3,689.0)	(3,842.1)	(3,842.1)	(3,842.1)
EBIT	11,479.0	7,692.0	7,151.2	7,103.8
Net interest inc./exp.)	(1,471.0)	(839.2)	(500.2)	(172.3)
Income/(loss) from associates	286.0	222.6	212.1	211.1
Pre-tax profit	10,008.0	6,852.8	6,651.1	6,931.5
Provision for taxes	(2,056.0)	(1,713.2)	(1,662.8)	(1,732.9)
Minority interest	0.0	0.0	0.0	—
Preferred dividends	—	—	—	—
Net inc. (pre-exceptionals)	7,952.0	5,139.6	4,988.3	5,198.6
Post-tax exceptionals	—	—	—	—
Net inc. (post-exceptionals)	7,952.0	5,139.6	4,988.3	5,198.6
EPS (basic, pre-exception) (Rmb)	1.10	0.71	0.69	0.72
EPS (diluted, pre-exception) (Rmb)	1.10	0.71	0.69	0.72
EPS (basic, post-exception) (Rmb)	1.10	0.71	0.69	0.72
EPS (diluted, post-exception) (Rmb)	1.10	0.71	0.69	0.72
DPS (Rmb)	0.22	0.14	0.14	0.14
Div. payout ratio (%)	20.0	20.0	20.0	20.0

Balance Sheet (Rmb mn)

	12/18	12/19E	12/20E	12/21E
Cash & cash equivalents	2,154.0	2,185.7	2,113.8	5,096.8
Accounts receivable	9,644.0	9,786.1	9,464.0	9,455.0
Inventory	13,125.0	13,856.8	13,418.6	13,411.0
Other current assets	2,032.0	2,032.0	2,032.0	2,032.0
Total current assets	26,955.0	27,860.6	27,028.4	29,994.8
Net PP&E	50,064.0	49,321.9	47,479.8	45,637.8
Net intangibles	6,315.0	6,315.0	6,315.0	6,315.0
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	6,690.0	6,690.0	6,690.0	6,690.0
Total assets	90,024.0	90,187.5	87,513.2	88,637.5
Accounts payable	9,063.0	9,196.5	8,893.8	8,885.4
Short-term debt	13,180.0	9,704.6	4,286.7	1,710.3
Other current liabilities	10,504.0	10,504.0	10,504.0	10,504.0
Total current liabilities	32,747.0	29,405.1	23,684.5	21,099.6
Long-term debt	2,295.0	1,689.8	746.4	297.8
Other long-term liabilities	2,517.0	2,517.0	2,517.0	2,517.0
Total long-term liabilities	4,812.0	4,206.8	3,263.4	2,814.8
Total liabilities	37,559.0	33,611.9	26,947.9	23,914.4
Preferred shares	—	—	—	—
Total common equity	51,962.0	56,072.6	60,062.3	64,220.1
Minority interest	503.0	503.0	503.0	503.0
Total liabilities & equity	90,024.0	90,187.5	87,513.2	88,637.5
Gross cash invested (ex cash)	122,315.0	126,155.4	127,697.7	129,689.7
Net debt, adjusted	13,321.0	9,208.7	2,919.3	(3,088.7)
Average capital employed	67,549.5	65,785.1	64,634.4	62,559.5
BVPS (Rmb)	7.18	7.75	8.30	8.88

Cash Flow (Rmb mn)

	12/18	12/19E	12/20E	12/21E
Net income	7,952.0	5,139.6	4,988.3	5,198.6
D&A add-back	3,689.0	3,842.1	3,842.1	3,842.1
Minority interest add-back	0.0	0.0	0.0	—
Net (inc)/dec working capital	4,256.0	(740.4)	457.6	8.1
Other operating cash flow	(7,603.0)	563.1	30.3	(42.1)
Cash flow from operations	8,294.0	8,804.3	9,318.3	9,006.7
Capital expenditures	(2,825.0)	(3,100.0)	(2,000.0)	(2,000.0)
Acquisitions	—	—	—	—
Divestitures	—	—	—	—
Others	(5,966.0)	—	—	—
Cash flow from investing	(3,882.0)	(3,100.0)	(2,000.0)	(2,000.0)
Dividends paid (common & pref)	(1,681.5)	(1,592.0)	(1,028.9)	(998.7)
Inc/(dec) in debt	(5,871.0)	(4,080.6)	(6,361.3)	(3,025.0)
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	(4,943.0)	(5,672.6)	(7,390.2)	(4,023.7)
Total cash flow	(283.0)	31.7	(71.9)	2,983.0
Free cash flow	5,469.0	5,704.3	7,318.3	7,006.7

Source: Company data, Goldman Sachs Research estimates.

We fine-tune our estimates for 2019E and 2020E (1-4%) and introduce 2021E. We maintain our Buy ratings on Angang H (on CL)/A — on the result, we revise our 12-month target price for Angang (H) to HK\$8.6/share (from HK\$8.5), and for Angang (A) to Rmb7.9/share (from Rmb8.5). Our target price methodology remains unchanged, based on historical P/B vs. ROE correlation — or 2020E P/B of 0.90X/0.95X (from 0.90X/1.0X) with ROE at 8.3%/8.3% (from 7.8%/7.8%) for H/A.

Exhibit 1: Key assumptions and financials - Angang

Key assumptions and financials - Angang							
Angang		2016A	2017A	2018A	2019E	2020E	2021E
Benchmark spot price (China)							
Spot-HRC	Rmb/t	2,820	3,842	4,143	3,978	3,815	3,824
Spot-CRC	Rmb/t	3,414	4,372	4,575	4,413	4,337	4,404
Spot-rebar	Rmb/t	2,408	3,787	4,118	3,542	3,292	3,185
Iron ore China CIF	Rmb/t	384	501	459	493	442	469
Hard coking coal	Rmb/t	870	1,429	1,503	1,410	1,339	1,280
Spread-HRC	Rmb/t	1,325	1,755	2,055	1,906	1,881	1,881
Spread-CRC vs HRC	Rmb/t	507	452	399	375	450	500
Spread-rebar	Rmb/t	973	1,708	2,063	1,530	1,430	1,330
Avg iron ore-parent	Rmb/t	464	655	667	734	681	695
% parent supply in total	Rmb/t	57%	67%	61%	59%	59%	59%
Sales volume	mnt	19.9	20.7	24.1	25.1	25.1	25.1
CRC/HRC/Gav	mnt	13.1	13.0	15.6	16.6	16.6	16.6
Heavy/medium plate	mnt	3.3	3.5	4.0	4.0	4.0	4.0
Wire and pipe	mnt	1.5	1.7	1.8	1.8	1.8	1.8
Section	mnt	1.1	1.4	1.7	1.7	1.7	1.7
CR silicon sheet	mnt	0.9	1.0	0.9	0.9	0.9	0.9
ASP	Rmb/t	2,703	3,739	4,038	3,939	3,799	3,795
Unit costs	Rmb/t	2,309	3,164	3,320	3,395	3,277	3,275
Unit gross profit	Rmb/t	394	575	718	545	522	520
Unit SG&A	Rmb/t	(179)	(200)	(200)	(199)	(199)	(199)
Unit EBIT-recurring	Rmb/t	215	374	519	345	323	321
Unit EBITDA-recurring	Rmb/t	392	499	619	460	438	436
Unit EBITDA-recurring	US\$/t	59	72	94	68	64	64
Unit finance cost	Rmb/t	(65)	(57)	(61)	(33)	(20)	(7)
EBIT-recurring	Rmb mn	4,342	6,835	11,237	7,692	7,151	7,104
EBITDA-recurring	Rmb mn	7,793	10,327	14,926	11,534	10,993	10,946
Net Profit	Rmb mn	1,616	5,605	7,952	5,140	4,988	5,199
Net Profit-recurring	Rmb mn	2,693	5,741	7,771	5,140	4,988	5,199
EPS	Rmb/sh	0.223	0.775	1.099	0.710	0.689	0.719
EPS-recurring	Rmb/sh	0.372	0.793	1.074	0.710	0.689	0.719
Operating cash flow	Rmb mn	4,349	6,268	8,294	8,804	9,318	9,007
Investing cash flow	Rmb mn	(550)	(1,345)	(3,882)	(3,100)	(2,000)	(2,000)
Free cash flow	Rmb mn	3,799	4,923	4,412	5,704	7,318	7,007
Net debt	Rmb mn	22,428	18,909	13,321	9,209	2,919	(3,089)
Net debt/Equity	%	50%	38%	25%	16%	5%	-5%
FCF	Rmb/sh	0.53	0.68	0.61	0.79	1.01	0.97
BV	Rmb/sh	6.20	6.91	7.18	7.75	8.30	8.88
ROE	%	3.6%	11.2%	15.3%	9.2%	8.3%	8.1%
ROE recurring	%	6.0%	11.5%	15.0%	9.2%	8.3%	8.1%
ROIC	%	4.2%	9.5%	13.4%	8.5%	8.2%	8.0%

Source: Company data, Goldman Sachs Global Investment Research

Key risks include: 1) steel prices, which are determined by the industry supply-demand balance; 2) government policies, in particular export-related taxes; and 3) cost pressure from iron ore, coal, and other raw materials.

Exhibit 2: 2018A results summary - Angang

FY18A results summary - Angang		FY18A	FY17A	YoY	FY18E	AvE
Revenue	Rmb mn	105,157	91,683	15%	102,914	2%
Sales tax	Rmb mn	(1,184)	(977)	21%	(1,251)	-5%
Net revenue	Rmb mn	103,973	90,706	15%	101,663	2%
COGS	Rmb mn	(88,126)	(78,707)	12%	(86,177)	2%
Gross profit	Rmb mn	15,847	11,999	32%	15,486	2%
Selling and distribution	Rmb mn	3,067	2,570	19%	3,036	1%
Admin & R&D	Rmb mn	1,749	1,915	-9%	1,959	-11%
Operation profit	Rmb mn	11,190	7,266	54%	10,468	7%
EBIT	Rmb mn	11,479	7,644	50%	10,781	6%
Finance cost, net	Rmb mn	(1,471)	(1,331)	11%	(1,362)	8%
Net profit	Rmb mn	7,952	6,638	20%	7,055	13%
NP-recurring	Rmb mn	7,771	6,770	15%	7,055	10%
EPS	Rmb/sh	1.099	0.917	20%	0.975	13%
EPS-recurring	Rmb/sh	1.074	0.936	15%	0.975	10%
EBIT-recurring	Rmb mn	11,237	7,820	44%	10,781	4%
EBITDA-recurring	Rmb mn	14,926	11,424	31%	14,698	2%
Spot-HRC (ex VAT)	Rmb/t	4,143	3,842	8%	4,143	0%
Spot-CRC	Rmb/t	4,575	4,372	5%	4,575	0%
Spot-rebar	Rmb/t	4,118	3,787	9%	4,118	0%
Iron ore China CIF	Rmb/t	459	501	-8%	459	0%
Sales	mn t	24.1	23.0	5%	23.6	2%
ASP	Rmb/t	4,038	3,676	10%	4,031	0%
Unit COGS	Rmb/t	3,320	3,113	7%	3,318	0%
Unit GP	Rmb/t	718	563	28%	713	1%
Unit SG&A	Rmb/t	(180)	(200)	-10%	(212)	-15%
Unit EBIT-recurring	Rmb/t	519	363	43%	501	3%
Unit Depr	Rmb/t	153	169	-9%	166	-8%
Unit EBITDA	Rmb/t	619	499	24%	623	-1%
Unit EBITDA	US\$/t	94	72	30%	95	-1%
AR days	days	34	53	-36%	45	-25%
AP days	days	32	38	-16%	32	-1%
Inv days	days	54	58	-7%	58	-6%
Net debt	Rmb mn	13,321	18,909	-30%	21,269	-37%
Net gearing	%	26%	38%	-32%	39%	-34%
OCF	Rmb mn	8,294	6,268	32%	8,367	-1%
FCF	Rmb mn	4,412	4,923	-10%	(678)	-750%

Source: Company data, Goldman Sachs Global Investment Research

Exhibit 3: Quarterly results summary - Angang

4Q18A results summary - Angang		1Q18A	2Q18A	3Q18A*	4Q18A*	YoY	QoQ
Net revenue	Rmb mn	21,211	25,101	30,577	27,084	6%	-11%
Net profit	Rmb mn	1,590	1,909	3,356	1,101	-61%	-67%
NP-recurring	Rmb mn	1,557	1,952	3,413	950	-68%	-72%
Volume	mnt	5.25	5.26	7.14	6.45	24%	-10%
Unit GP	Rmb/t	691	796	850	488	-45%	-43%
Unit EBITDA-recurring	Rmb/t	673	756	828	386	-51%	-53%

*Financial data merge Chaoyang steel

Source: Company data, Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

I, Trina Chen, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my 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).

For a more detailed description of how we calculate the GS Factor Profile, please contact your GS representative.

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Quantum

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GS SUSTAIN

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Disclosures

Coverage group(s) of stocks by primary analyst(s)

Trina Chen: A-share Basic Materials, China Basic Materials.

A-share Basic Materials: Aluminum Corp. of China (A), Angang Steel (A), Anhui Conch Cement (A), Baoshan Iron & Steel, BBMG Corp. (A), Chenming Paper (A), China Coal Energy (A), China Molybdenum Co. (A), Jiangxi Copper (A), Maanshan Iron & Steel (A), Shanying Int Holdings, Sun Paper, Yanzhou Coal Mining (A), Zijin Mining (A).

China Basic Materials: Aluminum Corp. of China (H), Angang Steel (H), Anhui Conch Cement (H), BBMG Corp. (H), Chenming Paper (H), China Coal Energy (H), China Hongqiao Group, China Molybdenum Co. (H), China National Building Material, China Resources Cement Holdings, Jiangxi Copper (H), Lee & Man Paper Manufacturing Ltd., Maanshan Iron & Steel (H), MMG Ltd, Nine Dragons Paper Holdings, West China Cement, Yanzhou Coal Mining (H), Zhaojin Mining Industry, Zijin Mining (H).

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Goldman Sachs makes a market in the securities or derivatives thereof: Angang Steel (A) (Rmb6.05) and Angang Steel (H) (HK\$6.29)

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Goldman Sachs Investment Research global Equity coverage universe

Rating Distribution

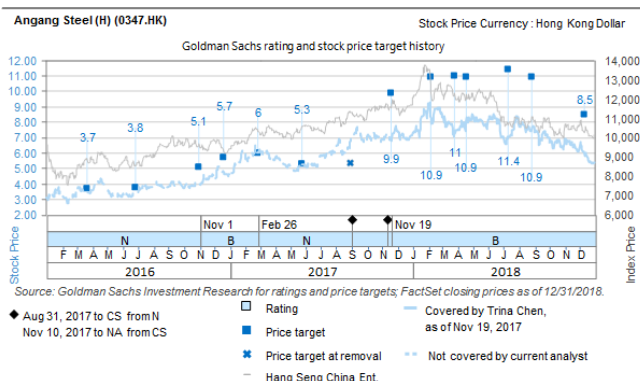
	Buy	Hold	Sell
Global	35%	54%	11%

Investment Banking Relationships

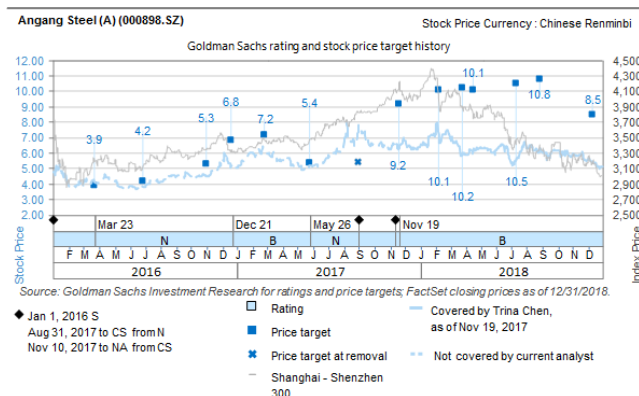
	Buy	Hold	Sell
	65%	58%	56%

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