



China steel sector

Feb steel PMI suggests improving industry fundamentals

	Ticker	Rec	Mkt cap		Price	PT	Up/ dn (%)	PER		PBR		EV/EBITDA	
			(US\$b)	Ccy				2015E	2016E	2015E	2016E	2015E	2016E
Angang	347 HK	OP	4.1	HKD	3.17	3.80	19.8	na	na	0.4	0.5	na	18.0
Magang	323 HK	IL	2.6	HKD	1.35	1.30	(3.7)	na	na	0.4	0.5	na	65.7

Source: Bloomberg, Company data, CSCI estimates

- **China's steel PMI continued to improve in Feb as new orders returned to expansion territory.**
- **Upgrade Magang to Neutral (323 HK, Neutral, PT \$1.3) as current valuation is less demanding after recent corrections. Angang (347 HK, Outperform, PT \$3.8) remains our preferred sector stock.**

China's February's Steel PMI climbs to 49.0:

According to China's Federation of Logistics and Purchasing, China's steel industry PMI has climbed to 49.0 in February (up from 46.7 in January). It marks the strongest growth since May 2014 though it also marks the twenty-second consecutive month of contraction. On the contrary, the broader manufacturing PMI figure released by NBS has edged lower to 49.0 (from 49.4 in January).

New orders returned to expansion territory:

On the positive side, China's steel new orders have edged back into expansion territory at 50.9 (from 49.9 in January) while export orders have retreated to 44.8 (from 50.7 in January). On the flip side, the production index has recovered to 49.5 (from 45.6 in January) and the products inventory has also climbed to 44.8 (from 34.4 in January).

Improving industry fundamental:

Rising steel products inventory has raised market concerns that steel mills may resume production in the near-term. However, according to China Iron and Steel Association's data, we expect China's crude steel production from key enterprises to come down by 9% YoY in the first two months of this year. On the other hand, steel mills would benefit from the continuous supply expansion of the overseas mining companies. Meanwhile, we expect an increasing visibility on the supply reform leading to a more balancing market ahead.

Earnings revision and recommendation update:

Based on the company's guidance, we have revised down our FY15 earnings forecasts for both Angang and Magang (see Fig 7). Without major changes in the industry outlook, we maintain our view that Angang will see a more solid earnings recovery going forward. On the back of recent share price corrections, we upgrade our rating on Magang from Underperform to Neutral, as its current valuation of 0.5x 2016E PBR looks reasonable. Angang remains our preferred steel play, with current valuation of 0.5x 2016E PBR, well below its 5YR historical average of 0.7x, or since-listed of 1.1x.

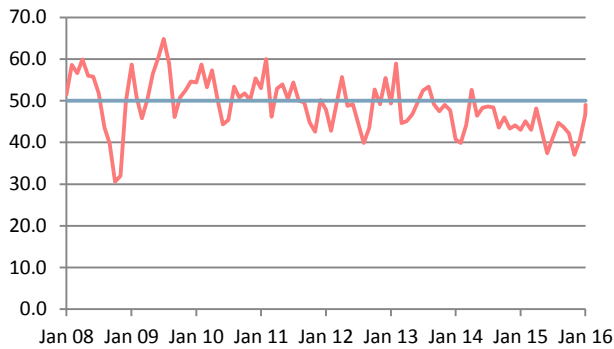
Duncan Chan

(CE No.: ALH659)

duncanchan@csci.hk

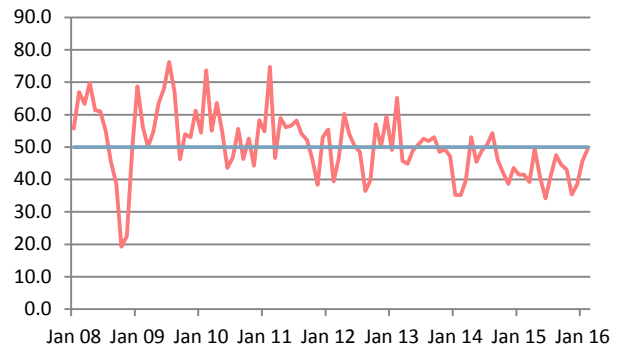
+852 3465 5654

Figure 1: China Steel PMI



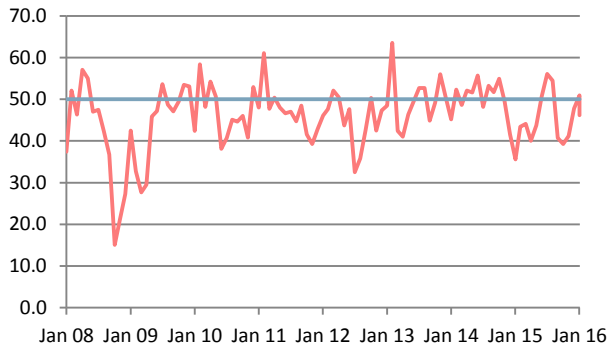
Source: Bloomberg

Figure 2: China Steel Production Index



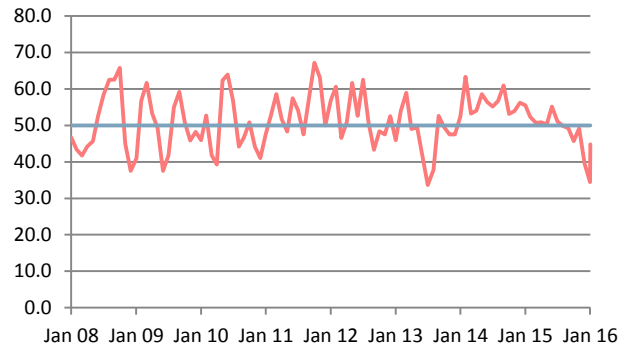
Source: Bloomberg

Figure 3: China Steel New Orders Index



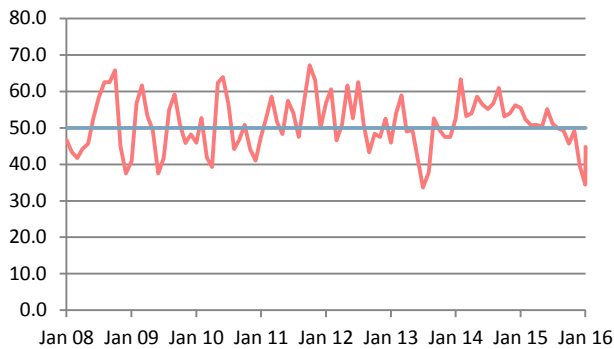
Source: Bloomberg

Figure 4: China Steel Export Orders Index



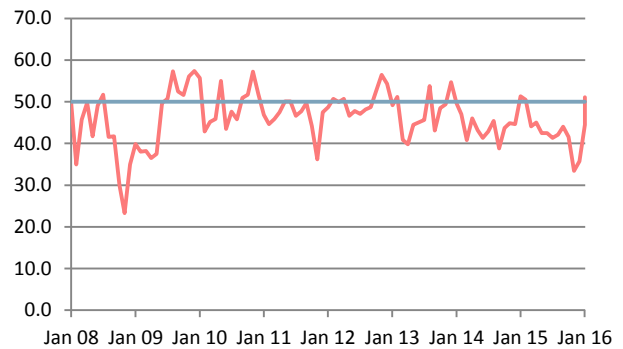
Source: Bloomberg

Figure 5: China Steel Products Stocks Index



Source: Bloomberg

Figure 6: China Steel Raw Materials Inventory Index



Source: Bloomberg

Figure 7: Forecast changes

	Angang			Magang		
	2015E	2016E	2017E	2015E	2016E	2017E
Revenue						
Prior	54,550	55,072	56,758	45,810	44,074	45,283
New	54,550	54,067	55,719	44,264	42,529	43,691
% revised	-	-1.8%	-1.8%	-3.4%	-3.5%	-3.5%
Net profit						
Prior	(2,000)	(424)	289	(3,898)	(2,097)	(1,443)
New	(4,380)	(1,564)	231	(4,830)	(3,084)	(2,475)
% revised	119.0%	268.9%	-20.1%	23.9%	47.1%	71.5%
EPS						
Prior	(0.28)	(0.06)	0.04	(0.51)	(0.27)	(0.19)
New	(0.61)	(0.22)	0.03	(0.63)	(0.40)	(0.32)
% revised	117.9%	266.7%	-25.0%	23.5%	48.1%	68.4%

Source: Bloomberg, CSCI Research

Figure 8: China steel price forecast changes

	Unit	2015	2016	Chg	2016E	Revised	2017E	Revised		
			YTD	%	Prior	New	%	Prior	New	%
Hot rolled	RMB/ton	2,317	2,028	-12%	2,025	2,025	-	2,086	2,086	-
Rebar	RMB/ton	2,244	2,048	-9%	2,050	2,050	-	2,071	2,071	-
Iron ore	US\$/ton	380	363	-4%	360	360	-	360	360	-

Source: Bloomberg

Figure 9: Angang's PBR band


Source: Bloomberg

Figure 10: Magang's PBR band


Source: Bloomberg

Angang's Financial summary

Income statement (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
Revenue	75,329	74,046	54,550	54,067	55,779
COGS	(67,123)	(65,703)	(53,241)	(49,338)	(48,935)
Gross profit	8,206	8,343	130	4,729	6,785
Selling expenses	(1,743)	(2,218)	(2,382)	(2,184)	(2,251)
General and administrative	(3,270)	(1,850)	(1,822)	(1,804)	(1,859)
Other opex	(1,866)	(2,111)	(1,732)	(1,614)	(1,664)
EBITDA	5,511	4,605	6,814	5,823	5,170
Depreciation & Amortization	(4,251)	(3,984)	(4,010)	(3,929)	(3,855)
EBIT	1,260	621	2,804	1,894	1,315
Interest income	309	372	358	361	368
Interest expense	(1,527)	(1,644)	(1,727)	(1,743)	(1,759)
JVs and associates	619	687	181	180	687
Others	-	-	-	-	-
Pretax profit	728	1,579	(5,815)	(2,076)	307
Taxation	27	(655)	1,454	519	(77)
Minority interests	15	4	(9)	(7)	1
Net profit	770	928	(4,380)	(1,564)	231
Net profit (adjusted)	770	928	(4,380)	(1,564)	231
Basic EPS (RMB)	0.11	0.13	(0.61)	(0.22)	0.03
Diluted EPS (RMB)	0.11	0.13	(0.61)	(0.22)	0.03
DPS (RMB)	0.03	0.05	-	-	-

Cash flow statement (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
EBIT	1,260	621	2,804	1,894	1,315
Depreciation & amortisation	4,251	3,984	4,010	3,929	3,855
Net interest	1218	1,272	1,369	1,382	1,391
Taxes paid	27	(655)	1,454	519	(77)
Changes in working capital	4,149	(4,008)	4,446	51	(261)
Others	(342)	923	(9,987)	(5,351)	(2,400)
Cash flow from operations	10,563	2,137	4,095	2,424	3,823
Capex	(2,948)	(4,416)	(4,000)	(3,000)	(3,000)
Acquisitions	(118)	(680)	-	-	-
Disposals	28	4	-	-	-
Others	448	667	-	-	-
Cash flow from investing	(2,590)	(4,425)	(4,000)	(3,000)	(3,000)
Dividends	(1,458)	(1,636)	-	-	-
Issue of shares	-	-	-	-	-
Change in debt	(8,512)	4,167	(500)	1,000	(500)
Others	-	343	-	-	-
Cash flow from financing	(9,970)	2,874	(500)	1,000	(500)
Change in cash	(1,997)	586	(405)	424	323
Free cash flow	7,615	(2,279)	95	(576)	823

Balance sheet (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
Cash	126	172	1,307	1,731	2,054
Short term investments	-	-	-	-	-
Accounts receivables	10,623	8,607	7,083	7,021	7,235
Inventory	12,356	10,865	9,411	8,719	8,647
Other current assets	5,194	5,440	5,067	5,054	5,098
Total current assets	29,299	26,624	22,869	22,525	23,035
PP&E	45,452	46,122	46,112	45,183	44,329
Intangible Assets	6,147	6,234	6,234	6,234	6,234
Total investments	3,184	4,004	4,004	4,004	4,004
Other long term assets	8,783	8,307	8,307	8,307	8,307
Total long term assets	63,566	64,667	64,657	63,728	62,874
TOTAL ASSETS	92,865	91,291	87,526	86,253	85,908
Short term debt	9,241	14,672	14,269	15,075	14,672
Accounts payables	15,343	8,289	9,578	8,874	8,800
Other current liabilities	13,220	13,790	13,597	13,585	13,584
Total current liabilities	37,804	36,751	37,443	37,535	37,056
Long term debt	3,044	1,371	1,274	1,468	1,371
Deferred tax	956	990	990	990	990
Bonds payable	3,971	3,983	3,983	3,983	3,983
Other long term liabilities	-	-	-	-	-
Total long term liabilities	7,971	6,344	6,247	6,441	6,344
TOTAL LIABILITIES	45,775	43,095	43,691	43,975	43,400
Shareholders' funds	47,026	47,793	43,413	41,850	42,081
Minority interests	64	403	422	429	428
TOTAL LIAB AND EQUITY	92,865	91,291	87,526	86,253	85,908
Net cash / (debt)	(15,130)	(18,314)	(18,219)	(18,795)	(17,972)

Source: Company data, CSCI estimates

Key ratios

Year end: Dec	2013	2014	2015E	2016E	2017E
Operating ratios					
Gross margin	10.9	11.3	2.4	8.7	12.2
EBITDA margin (%)	7.3	6.2	12.5	10.8	9.3
Effective tax rate (%)	(3.7)	41.5	25.0	25.0	25.0
Revenue growth (%)	(3.7)	(1.7)	(26.3)	(0.9)	3.1
Net income growth (%)	-	20.5	(572.0)	(64.3)	(114.8)
EPS growth adj (%)	-	20.5	(572.0)	(64.3)	(114.8)
DPS growth (%)	-	67.2	-	-	-
Efficiency ratios					
ROE (%)	16	19	(10.1)	(3.7)	0.5
ROCE (%)	0.5	0.6	0.6	0.6	0.6
Asset turnover (x)	0.8	0.8	0.6	0.6	0.6
Op cash / EBIT (x)	34.2	5.7	11.4	6.7	10.4
Depreciation / CAPEX (x)	14	0.9	10	13	13
Accounts receivable days	58.2	57.2	63.5	57.4	56.3
Accounts payable days	67.1	67.0	63.2	69.6	67.3
Leverage ratios					
Net gearing (%)	32.2	38.3	42.0	44.9	42.7
Net debt / EBITDA (x)	2.7	4.0	2.7	3.2	3.5
Interest cover (x)	0.3	0.3	0.3	0.3	0.3
Current ratio (x)	0.8	0.7	0.6	0.6	0.6
Valuation					
PER (x)	25.0	20.7	-	-	83.3
EV/EBITDA (x)	8.7	8.4	-	18.0	10.3
PBR (x)	0.4	0.4	0.4	0.5	0.5
Dividend yield (x)	0.0	0.0	-	-	-

Magang's Financial summary

Income statement (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
Revenue	73,849	59,821	44,264	42,529	43,691
COGS	(70,620)	(56,076)	(47,397)	(43,379)	(43,388)
Gross profit	3,228	3,745	(3,133)	(851)	303
Selling expenses	(423)	(513)	(719)	(551)	(566)
General and administrative	(1,334)	(1,311)	(1,975)	(1,580)	(1,623)
Other opex	(1,164)	(770)	(828)	(772)	(793)
EBITDA	4,755	4,510	7,673	6,552	6,124
Depreciation & Amortization	(3,766)	(3,558)	(3,604)	(3,414)	(3,242)
EBIT	989	952	4,069	3,138	2,882
Interest income	168	176	121	94	124
Interest expense	(1,322)	(1,419)	(1,312)	(1,394)	(1,531)
JVs and associates	169	604	139	134	137
Others	-	-	-	-	-
Pretax profit	322	512	(7,708)	(4,921)	(3,950)
Taxation	(114)	(248)	1927	1230	987
Minority interests	(51)	(43)	951	607	487
Net profit	157	221	(4,830)	(3,084)	(2,475)
Net profit (adjusted)	157	221	(4,830)	(3,084)	(2,475)
Basic EPS (RMB)	0.02	0.03	(0.63)	(0.40)	(0.32)
Diluted EPS (RMB)	0.02	0.03	(0.63)	(0.40)	(0.32)
DPS (RMB)	-	-	-	-	-

Cash flow statement (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
EBIT	989	952	4,069	3,138	2,882
Depreciation & amortisation	3,766	3,558	3,604	3,414	3,242
Net interest	154	1244	191	1301	1408
Taxes paid	(114)	(248)	1927	1230	987
Changes in working capital	(440)	(2,641)	1634	99	(82)
Others	(264)	48	(12,969)	(9,360)	(8,240)
Cash flow from operations	5,091	2,913	(543)	(177)	98
Capex	(5,521)	(2,708)	(3,000)	(1,500)	(1,500)
Acquisitions	(88)	(105)	-	-	-
Disposals	761	1629	-	-	-
Others	305	2,511	-	-	-
Cash flow from investing	(4,543)	1,326	(3,000)	(1,500)	(1,500)
Dividends	(1294)	(1401)	-	-	-
Issue of shares	-	-	-	-	-
Change in debt	(4,288)	(1974)	-	3,000	2,000
Others	281	30	-	-	-
Cash flow from financing	(5,301)	(3,344)	-	3,000	2,000
Change in cash	(4,752)	895	(3,543)	1,323	598
Free cash flow	(429)	205	(3,543)	(1677)	(1402)

Balance sheet (RMBm)

Year end: Dec	2013	2014	2015E	2016E	2017E
Cash	5,107	4,655	1,111	2,434	3,032
Short term investments	-	-	-	-	-
Accounts receivables	8,629	8,484	6,331	6,083	6,249
Inventory	10,050	8,684	7,921	7,249	7,249
Other current assets	4,811	3,063	2,819	2,795	2,811
Total current assets	28,597	24,885	18,183	18,561	19,342
PP&E	30,668	37,041	36,438	34,523	32,781
Intangible Assets	1,900	1,826	1,826	1,826	1,826
Total investments	1,077	1,216	1,216	1,216	1,216
Other long term assets	9,579	3,542	3,542	3,542	3,542
Total long term assets	43,225	43,626	43,022	41,108	39,366
TOTAL ASSETS	71,822	68,511	61,205	59,669	58,708
Short term debt	8,554	12,058	12,058	13,971	15,246
Accounts payables	6,524	6,679	5,583	5,109	5,109
Other current liabilities	22,011	13,967	13,538	13,67	13,67
Total current liabilities	37,088	32,705	31,180	32,247	33,523
Long term debt	6,059	6,339	6,339	7,426	8,151
Deferred tax	647	1,245	1,245	1,245	1,245
Bonds payable	2,328	2,333	2,333	2,333	2,333
Other long term liabilities	-	-	-	-	-
Total long term liabilities	9,034	9,917	9,917	11,004	11,729
TOTAL LIABILITIES	46,123	42,622	41,097	43,251	45,252
Shareholders' funds	23,131	23,296	18,465	15,382	12,907
Minority interests	2,568	2,594	1,643	1,036	549
TOTAL LIAB AND EQUITY	71,822	68,511	61,205	59,669	58,708
Net cash / (debt)	(11,835)	(16,076)	(19,619)	(21,296)	(22,699)

Source: Company data, CSCI estimates

Key ratios

Year end: Dec	2013	2014	2015E	2016E	2017E
Operating ratios					
Gross margin	4.4	6.3	(7.1)	(2.0)	0.7
EBITDA margin (%)	6.4	7.5	17.3	15.4	14.0
Effective tax rate (%)	35.5	48.4	25.0	25.0	25.0
Revenue growth (%)	(0.7)	(19.0)	(26.0)	(3.9)	2.7
Net income growth (%)	-	40.3	(2,289.4)	(36.2)	(19.7)
EPS growth adj (%)	-	40.3	(2,289.4)	(36.2)	(19.7)
DPS growth (%)	-	-	-	-	-
Efficiency ratios					
ROE (%)	0.7	0.9	(26.2)	(20.0)	(19.2)
ROCE (%)	0.4	0.4	0.3	0.2	0.3
Asset turnover (x)	10	0.9	0.7	0.7	0.7
Op cash / EBIT (x)	30.3	16.6	(4.5)	(1.9)	0.8
Depreciation / CAPEX (x)	0.7	1.3	1.2	2.3	2.2
Accounts receivable days	46.7	57.3	67.1	58.4	56.5
Accounts payable days	62.7	77.0	82.9	80.5	77.0
Leverage ratios					
Net gearing (%)	51.2	69.0	106.2	138.4	175.9
Net debt / EBITDA (x)	2.5	3.6	2.6	3.3	3.7
Interest cover (x)	0.1	0.1	0.1	0.1	0.1
Current ratio (x)	0.8	0.8	0.6	0.6	0.6
Valuation					
PER (x)	55.5	39.5	-	-	-
EV/EBITDA (x)	7.7	7.3	-	-	65.5
PBR (x)	0.3	0.3	0.4	0.5	0.6
Dividend yield (x)	-	-	-	-	-



Research

LIU Taisheng, Steven
TMT
(852) 3465 5652
stevenliu@csci.hk

SO Lai Shan, Jennifer
Consumer
(852) 3465 5781
jenniferso@csci.hk

CHAN Ka Yeung, Duncan
Commodity
(852) 3465 5654
duncanchan@csci.hk

TIAN Yang
Automotive
(852) 3465 5775
tianyong@csci.hk

SUN Lingxiao, Roger
Industrials
(852) 3465 5785
rogersun@csci.hk

XU Bo, Albert
Financials
(852) 3465 5789
albertxu@csci.hk

ZHU Kexin
Renewable energy
(852) 3465 5653
zhukexin@csci.hk

DUAN Xiaoxin, Joyce
Consumer
(852) 3465 5790
joyceduan@csci.hk

Institutional Sales & Trading

XIANG Xinrong, Ron
(852) 3465 5633
ronxiang@csci.hk

CAO Xiaogang, Glen
(852) 3465 5658
caoxiaogang@csci.hk

YUAN Zhefei, Annie
(852) 3465 5657
annieyuan@csci.hk

ZHANG Meng, Maurice
(852) 3465 5656
mauricezhang@csci.hk

HO Wen Hao, Jack
(852) 3465 5685
jackho@csci.hk

HO Hung Wei
(852) 3465 5687
hohungwei@csci.hk

LEE Ying Ju, Rose
(852) 3465 5707
roselee@csci.hk

AO Yiyu, Diana
(852) 3465 5708
dianaao@csci.hk

WANG Fei, Sophie
(852) 3465 5709
sophiewang@csci.hk

XIA Tian
(852) 3465 5670
xiatian@csci.hk

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Outperform	Relative Performance >10%
Neutral	Relative Performance is -10% to 10%
Underperform	Relative Performance <10%

Disclosure of Interests

As of the date of this report,

1. The research analysts primarily responsible for the preparation of all or part of this report hereby certify that:
 - (i) the views expressed in this research report accurately reflect the personal views of each such analyst about the subject securities and issuers; and
 - (ii) no part of the analyst's compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed in this research report.
2. The research analysts primarily responsible for the preparation of all or part of this report, or his/her associate(s), do not have any interest (including any direct or indirect ownership of securities, arrangement for financial accommodation or serving as an officer) in any company mentioned in this report,
3. This report has been produced in its entirety by China Securities (International) Brokerage Company Limited ("China Securities (International)") (CE Number: BAU373, regulated by the Securities and Futures Commission in Hong Kong)
4. China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities have no financial interest, in aggregate, equal to or more than 1% of the market capitalization in the stocks reviewed in this report.
5. China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities have not received compensation from or mandates for investment banking services in the past 12 months from listed corporations whose stocks are being reviewed by China Securities (International) in this report.
6. China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities do not have any individual employed by or associated with them serving as an officer of a listed corporation whose stocks are being reviewed by China Securities (International) in this report.
7. China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities are not market makers in the stocks reviewed by China Securities (International) in this report.

Disclaimer

This report is for information purposes only and should not be construed as an offer to sell or to solicitation of an offer to buy or sell any securities in any jurisdiction. The securities referred to in this research report may not be eligible for sale in some jurisdictions. This information contained in this report has been compiled by China Securities (International) from sources that it believes to be reliable and (subject to the above Disclosure of Interests) the opinions, analysis, forecasts, projections and expectations contained in this report are based on such information and are expressions of belief only and no representation, warranty or guarantee is made or given by China Securities (International) or any its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of China Securities (International) as of the date of this report only and are subject to change without notice. Such opinions and estimates may be different from or contrary to the opinions presented by the other business departments, units or affiliates of China Securities (International), as different assumptions and standards, different views and analytical methods may be adopted in the preparation of such other materials, and China Securities (International) is under no obligation to bring such other materials to the attention of any recipient of this report. Neither China Securities (International) nor its holding companies and affiliates accept any liability whatsoever for any direct or consequential loss arising from any use of material contained in this report or otherwise arising in connection therewith.

Any investment referred to herein may involve significant risk, may be illiquid and may not be suitable for all investors. The value of or income from any investment referred to herein may fluctuate and be affected by changes in exchange rates. Past performance is not indicative of future results. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors are expected to make their own investment decision without relying on this publication. Before entering into any transactions in any securities referred to in this research report investor should consider their own individual investment objectives and financial situation and seek professional financial, tax and legal advice, as necessary.

This report is strictly confidential to the recipient. It is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose. The distribution of this report in other jurisdictions may be restricted by law, and persons into whose possession this report comes should inform themselves about, and observe, any such restrictions. By accepting this report you agree to be bound by the foregoing instructions.

China Securities (International) Research

18/F, Two Exchange Square, Central, Hong Kong

Tel: (852) 34655600 Fax: (852)21809495