Equity Research l China l Steel

25 April 2016

China steel sector

Potential impact on Tangshan International Horticultural Exposition 2016

	Ticker	Rec	Mkt cap (US$b)	Ccy	Price	PT	Up/ dn (%)	PER 2016E	PER 2017E	PBR 2016E	PBR 2017E	EV/EBITDA 2016E	EV/EBITDA 2017E
Angang	347 HK	BUY	4.1	HKD	3.99	5.00	25.3	na	71.5	0.6	0.6	11.7	9.4
Magang	323 HK	BUY	2.6	HKD	1.76	2.00	13.6	na	na	0.6	0.6	na	14.6

**Price as of 22 April 2016*
Source: Bloomberg, Company, CSCI Research estimate

- **The Tangshan International Horticultural Exposition 2016 will kick off in Hebei province from this Friday, April 29 through October. This will be the fifth world horticultural expo to be held in China after 1999, 2006, 2011 and 2014. Based on past experience, some analysts estimated steel production will be cut by around 10% in Hebei during the event period amid capacity suspension enforcement in an effort to reduce industrial pollution.**
- **Despite the increasing granularity of supply side reform recently, we believe the reform progress would likely gather pace from the 2H of this year, given the government's message to slash steel production has remained clear thus far.**
- **Since first quarter losses for both Angang and Magang have substantially narrowed from the last quarter of 2015, and thus in anticipation of sequential earnings improvement to continue going forward, we believe their current valuations remain undemanding. As such, we maintain our BUY rating with target multiples unchanged at 0.7x PBR for both companies.**

Potential temporary production suspension in Hebei

Based on past experience, the expo peripheral areas would be subject to environmental protection, likewise during the parade ceremony held in Beijing last September. Pollution-intensive activities in Hebei, including steel plants are likely to be subject to temporary suspension during the event period. Some data suggest that crude steel production could be reduced by as much as 20mn tons, equivalent to 10% of Hebei's total crude steel production in 2015, while the actual impact on production would be subject to further investigation.

Supply reform has not started thus far

The seasonal consumption pick up, refer our previous note on Improving consumption outlook dated 12 April 2016, as driven by both real estate investment and infrastructure projects and financing demand, coupled with steel inventory at historic low level, has fuelled the recent rebound in domestic steel price. We noted that China's steel production has rebounded after steel mills reported earnings improvement on higher steel prices Given the government's determination to resolve the overcapacity situation has remained firm thus far and the proposed plant closure target has not yet been widely implemented, together with a special fund having been established and tighter credit flow, we foresee the supply-side reform progress should gather pace from 2H16, which would lessen the deterioration in capacity utilization going forward. The industry would benefit when the structural imbalance is being gradually brought back into balance as a result, in our view.

Valuations remain undemanding on sequential earnings improvement

Angang warned that it would continue to make a loss in 1Q16 although losses have narrowed substantially since the last quarter of 2015, while Magang is also expected to post a net loss in the first quarter. However, we believe both Angang and Magang should be able to return to profit making given the recovery in the steel price. Considering that both companies are likely to continue to see sequential earnings improvement going forward, we believe their current valuations remain undemanding. As such, we maintain our BUY rating for Angang and Magang, with our price targets unchanged at HKD5.0 and HKD2.0 respectively, representing corresponding PBR of 0.7x.

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Company Rating Definition

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

Buy	12-month absolute total return: >=10%
Hold	12-month absolute total return: >-10% but <10%
Sell	12-month absolute total return: <=-10%

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