

Maanshan Iron and Steel (H-shares)

Back to profitability

Earnings Summary

Year-end 31 Dec	Turnover (Rmb m)	Net profit (Rmb m)	Change (%)	EPS (Rmb)	Change (%)	DPS (Rmb)	P/E (x)	Yield (%)
2006	34,320	2,394	-18	0.37	-18	0.13	11.4	3.1
2007	49,053	2,467	+3	0.38	+3	0.13	11.1	3.1
2008	70,010	710	-71	0.10	-74	-	42.1	-
2009F	52,463	807	+14	0.11	+10	-	38.2	-
2010F	57,709	1,697	+110	0.22	+100	0.04	19.1	1.0

IBES consensus EPS estimates – FY09: Rmb0.11; FY10: Rmb0.32

Investment Summary

- Magang's 3Q09 results, prepared under PRC GAAP, confirmed that the worst might be over for the Anhui-based steelmaker. Underpinned by China's increased infrastructure investment, Magang is on track to return to profitability in 2H09. In line with our expectation, Magang's 3Q09 net profit was up 2% yoy to Rmb802m, against the Rmb795m net loss in 1H09.
- We remain optimistic on Magang's business outlook, supported by China's sustained investment in real estate and railway construction, though steel prices would be depressed by high inventory in the short term. However, we believe Magang's exposure to long steel and railway-related steel products would continue to help mitigate the pressure on earnings, until a fuller industry recovery in 2010, backed by the central government's restructuring plans to curb the industry's excess capacity. We reiterate our Buy recommendation, though we have downgraded our target price from \$6.28 to \$5.85 after revising down our FY09 and FY10 EPS estimates by 13% and 35%, respectively, whilst keeping a forward end-FY10 P/B of 1.4x.
- In 3Q09, although Magang's turnover dropped 28% yoy to Rmb14.4b, through better management of cost of sales and selling expenses, the company increased its gross margin by 17 bps to 10.1% and operating profit margin by 1.0 ppt to 6.0%. The drop in turnover actually decelerated from a yoy decline of 38% in 1H09. The 14% steel price hike between July and August on the back of increased demand aided performance in 3Q09. Magang's 3Q09 net profit was also boosted by a lower effective tax rate and a 54% fall in interest expenses.
- The 4Q09 steel price will remain subdued given the high inventory level, built up as steelmakers anticipated a surge in demand from the government's Rmb4t stimulus package. We believe the restructuring guidelines for China's steel industry to be announced shortly should halt the overproduction and ensure the imbalance between supply and demand is eliminated in 2010.
- With property construction up in 4Q09, there has been a modest recovery in the long steel and wire rod market. The China Iron and Steel Association's price indexes for long steel and wire rod rose 0.4% and 1.0%, respectively, over the past two weeks, the first weekly rise since mid-September. The price hikes are positive for Magang, since long steel and wire rod, used primarily for structural construction, accounted for almost half of its revenue in FY08.

2 Nov 2009

BUY

12M target price \$5.85 (+23%)

Stock Data

Last price: \$4.79 Stock code: 0323.HK

Related A-shares: 600808.CH (Rmb4.37)

Sector: Basic Materials

shares: 1,732.9m (22.5% of total issued shares)

Mkt cap: \$8,300m Free float: 77%

Major shareholder: JP Morgan Chase (8%), UBS AG (5%), HSBC Holdings, (5%), Deutsche Bank (5%)

Price Performance

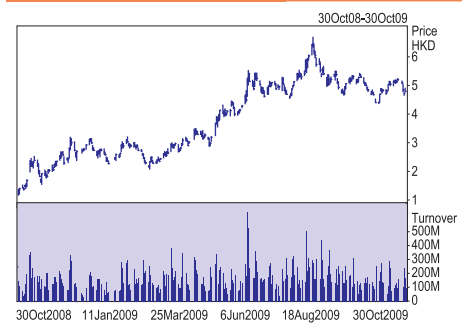
Price change: 1M: +2% 3M: -19% 12M: +286%

12M H/L: \$6.46/\$1.24

12M daily turnover: 49.7m shares

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Price Chart



Source: Bloomberg

Company Background

Listed on the Hong Kong Stock Exchange in 1993 and the Shanghai Stock Exchange the following year, Magang is one of the largest iron and steel producers in China. Based in Anhui, the company produces steel plates, section steel and wire rods for infrastructure and automobile construction, ship and bridge building, petroleum transportation, machinery, and appliances. Magang is also the leader in the manufacture of train wheels and rims used in railway transportation equipment, a niche market for the company.

P/L Summary

Year-end 31-Dec	2006 Rmb m	2007 Rmb m	2008 Rmb m	2009F Rmb m	2010F Rmb m
Revenue	34,319	49,053	70,009	52,463	57,709
Cost of sales	(29,904)	(43,478)	(65,777)	(49,245)	(52,652)
Gross profit	4,415	5,575	4,232	3,218	5,057
Other income and gains	199	183	311	313	312
Selling expenses	(469)	(919)	(1,145)	(435)	(944)
Administrative expenses	(1,089)	(1,025)	(951)	(1,070)	(1,177)
Finance costs	(296)	(1,156)	(1,840)	(1,067)	(1,067)
Share of profit/(losses) of JVC	-	34	68	62	62
Share of profit/(losses) of associates	40	97	131	86	86
Profit before taxation	2,800	2,789	806	1,107	2,329
Income tax expense	(347)	(220)	(75)	(276)	(582)
Net profit	2,453	2,569	731	831	1,747
Minority interest	58	102	21	24	50
Net profit attributable to equity holders	2,395	2,467	710	807	1,697

Financial Summary

Financial year	2004	2005	2006	2007	2008
Key financial data :					
Non-current assets (Rmb m)	21,256	27,691	41,983	47,857	46,897
Current assets (Rmb m)	9,940	11,243	12,734	23,058	19,386
Current liabilities (Rmb m)	9,380	10,783	12,571	25,450	18,526
Net current assets/(liabilities) (Rmb m)	560	460	163	(2,392)	860
Long term liabilities (Rmb m)	4,714	9,498	20,772	22,009	21,230
Shareholders' funds (Rmb m)	17,025	18,515	20,461	23,009	26,007
Net cash/(debt) (Rmb m)	(3,312)	(7,649)	(12,892)	(17,136)	(11,607)
Book value per share (Rmb)	2.64	2.87	3.17	3.40	3.38
Net cash/(debt) per share (Rmb m)	n/a	n/a	n/a	n/a	n/a
EPS (Rmb)	0.56	0.45	0.37	0.38	0.10
DPS (Rmb)	0.22	0.16	0.13	0.13	-
Key ratios :					
Current ratio (x)	1.1	1.0	1.0	0.9	1.0
Gearing ratio (x)	0.3	0.6	0.8	1.0	0.7
Return on equity (%)	22.6	16.4	12.3	11.4	2.9
Operating margin (%)	16.0	10.5	8.2	5.7	1.2
Gross margin (%)	22.3	14.7	12.9	11.4	6.0
Effective tax rate (%)	11.3	12.3	12.0	7.9	9.3
Interest coverage (x)	19.1	10.2	10.3	3.3	1.3
Dividend payout (%)	39.5	35.5	35.0	35.6	-
Net profit growth (%)	35.1	(19.0)	(17.7)	3.0	(71.2)
EPS growth (%)	35.1	(19.0)	(17.7)	(2.6)	(72.7)

Notes: (1) "\$" refers to HK dollars throughout this report unless otherwise stated.

(2) Share prices and indices are as of 30 Oct 09 (HSI: 21,753)

Recommendation Policy

BUY if current price is more than 10% below AFV.

HOLD if current price within +/-10% from AFV.

SELL if current price is more than 10% above AFV.

AFV (Assessed Fair Value) is arrived at based on various appropriate valuations, including P/E, Yield, NAV, DCF, EV/EBITDA, and management quality, etc, with regard to prevailing interest rates and comparative valuations.

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