

China / Hong Kong Company Update

China Hongqiao Group

Bloomberg: 1378 HK Equity | Reuters: 1378.HK

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DBS Group Research . Equity

8 Nov 2022

BUY

Last Traded Price (7 Nov 2022): HK\$6.64 (HSI : 16,596)
Price Target 12-mth: HK\$8.50 (28% upside) (Prev HK\$12.00)

Analyst

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What's New

- 3Q22 earnings dropped 36% y-o-y on product GP contraction, in line
- Aluminium capacity utilisation is stable
- Capacity relocation to Yunnan is progressing well
- Maintain BUY and lower TP to HK\$8.5 after earnings cut

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2021A	2022F	2023F	2024F
Turnover	114,491	129,983	125,010	131,466
EBITDA	32,830	28,057	27,238	30,784
Pre-tax Profit	22,554	18,569	17,713	21,343
Net Profit	16,073	13,234	12,623	15,210
Net Profit Gth (Pre-ex) (%)	53.1	(17.7)	(4.6)	20.5
EPS (HK\$)	1.94	1.50	1.43	1.72
EPS (RMB)	1.77	1.37	1.31	1.58
EPS Gth (%)	45.1	(22.7)	(4.6)	20.5
Diluted EPS (HK\$)	1.82	1.50	1.43	1.72
DPS (HK\$)	1.15	0.72	0.69	0.83
BV Per Share (HK\$)	9.79	9.81	10.39	11.09
PE (X)	3.4	4.4	4.6	3.9
P/Cash Flow (X)	1.9	5.8	2.8	2.8
P/Free CF (X)	2.4	12.9	3.8	3.8
EV/EBITDA (X)	2.0	2.6	2.4	1.9
Net Div Yield (%)	17.3	10.8	10.3	12.4
P/Book Value (X)	0.7	0.7	0.6	0.6
Net Debt/Equity (X)	CASH	0.0	CASH	CASH
ROAE(%)	21.1	15.8	14.1	16.0

Earnings Rev (%)	(19)	(31)	New
Consensus EPS (RMB)	1.56	1.72	2.07
Other Broker Recs:	B:11	S:0	H:2

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Relocation to Yunnan in progress

Investment Thesis

Prime beneficiary of rebound in downstream aluminium demand. We believe the share price weakness since 2Q has mostly priced in the weaker-than-expected consumption environment that was a result of COVID disruptions. On the contrary, we expect the potential aluminium price rebound to serve as a share price catalyst in view of the continuous society inventory drawdown.

Gross profit outlook. We expect Hongqiao's 4Q unit GP to recover from its trough level this year and be at par or lower than last year. Looking forward, we believe that the company's unit GP could improve, underpinned by the expected ASP pick up and access to cheaper energy cost in Yunnan as well as rising cost efficiency, which may help to deliver superior margins as compared to its industry peers.

Maintain BUY. We cut our FY22F/FY23F earnings estimate by 19%/31% on our new assumption in unit selling price of aluminium products – which translates to an unchanged CAGR of 7% during 2022-2024.

Valuation:

Our TP of HK\$8.5 is based on 0.8x FY22F P/B, which is the average value of its five-year historical figures during 2018-2022, against mid-teen ROE for 2022 and 2023. The projected net dividend yield of >11% is attractive.

Where we differ:

Our earnings CAGR (2022-2024) is higher than consensus, as we expect GPM can be maintained amid cost efficiency.

Key Risks to Our View:

Unexpected market supply expansion or collapse in demand may adversely impact our assumptions.

At A Glance

Issued Capital (m shrs)	9,121
Mkt Cap (HKm/US\$m)	60,563 / 7,715
Major Shareholders (%)	
China Hongqiao Holdings Ltd.	65.1
CITIC Trust Co., Ltd.	8.6
Free Float (%)	26.3
3m Avg. Daily Val. (US\$m)	13.2
GICS Industry: Materials / Metals & Mining	

China Hongqiao Group

WHAT'S NEW

3Q22 earnings fell on higher input cost; industry smelting capacity is unchanged

Hongqiao's 3Q22 operating results in line. China Hongqiao has disclosed the 3Q22 financial performance for Shandong Hongqiao New Material Co., Ltd. to comply to the local bonds market requirement. The results do not reflect its bauxite revenue contribution from overseas. Revenue rose by 18% y-o-y in 3Q22, with GP declined 31% y-o-y on product margin contraction on higher input cost. This led to net earnings falling by 36% y-o-y. Overall results were in line with expectations.

Overall capacity and sales volume stable. Based on our understanding, the company achieved stable sales volume of aluminium products at >1.5m tons in 3Q22 (or c.4.5m tons 9M22). In the meantime, the full year target of aluminium sales is maintained at 5.8-5.9m tons, representing >10% increase on year. And thus, we expect Hongqiao should be able to maintain its aluminium capacity utilisation at about 90% (100% for alumina capacity) for this year, in line with industry average.

Cost rise linked to oil product price volatility. Thermal coal power remained the key energy source for Hongqiao, which we believe is a near term risk. Average coal input cost surged to RMB1,100 (tax inclusive) during 3Q22. Apart from power energy, other major materials including bauxite, alumina and anode are linked to prices of fuel oil products used for transportation. Despite this, Hongqiao was still able to maintain its position at the top 10 percentile of the industry's least cost curve in China.

Hongqiao's strategic move into Yunnan province in progress. Hongqiao's Yunnan operation has also suffered from the unstable hydro power supply this year. The overall impact was small for Hongqiao's Yunnan plant, which has only 1mtpa (15% of total) and local tariff was 20% per kWh cheaper than thermal power. Meanwhile, China Southern Power Grid has invested to boost its capacity to resolve the power stability issue. For Hongqiao,

its Wenshan Phase II's 1mtpa plant will commence by 1Q2023 and will move 1.93mtpa to Honghe in the next five years to raise Yunnan's contribution to 60% of total.

No sign of influx of aluminium supply from Russia yet.

China's policy of capping aluminium smelting capacity at a ceiling of 45m tonnes remains in place. For overseas market, overall supply is dependent on the power shortage in Europe and LME in talk to ban Russian metals amid sanctions. However, comment from producers is that they have not seen an influx of aluminium imports from Russia at the moment. In the near term, the power supply in Yunnan could cloud the overall domestic supply landscape.

Maintain BUY. We have slashed our FY22F/F23F earnings estimate by 19% and 31% on lower GP assumptions. Although the industry's outlook would be clouded by the US dollar's strength in the near term, we foresee the market to recover on a sequential basis underpinning by the tight aluminium supply outlook. Valuation wise, Hongqiao is trading at 0.6x FY23F P/B, relative to our target multiple of 0.8x, suggesting share price potential upside >10%, thus, maintain our BUY rating.

Company Background

China Hongqiao Group ("CHG") is a vertically integrated aluminium producer in China. CHG is engaged in the production of a wide range of products from bauxite, alumina, and aluminium to fabricated products. CHG was the largest aluminium producer in China as at end-2021, with a 6.46mtpa production capacity. CHG has codeveloped a bauxite mine in Guinea and operates an alumina plant in Indonesia. The company's sales volumes of aluminium and alumina were 5.0m tonnes and 7.1m tonnes, respectively, in 2021.

China Hongqiao Group

Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
Sales volume for alumina ('000 tonnes)	6,734.0	7,163.0	6,652.9	6,652.9	6,652.9
Sales volume for aluminum products ('000 tonnes)	5,060.0	5,052.0	5,700.0	5,900.0	6,100.0
ASP for alumina (RMB/tonne)	2,002.8	2,368.7	2,510.8	2,535.9	2,561.3
ASP for aluminum products (RMB/tonne)	12,501.4	16,689.0	17,699.1	16,371.7	16,814.2
GPM for aluminum products (%)	23.8	27.6	20.9	21.3	24.2

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenues (RMB m)					
Alumina	13,487	16,967	16,704	16,871	17,040
Aluminum products	72,038	96,837	112,513	107,349	113,613
Others	619	687	765	789	813
Total	86,145	114,491	129,983	125,010	131,466
Gross Profit (RMB m)					
Alumina	2,210	3,986	4,165	4,457	4,750
Aluminum products	17,121	26,733	23,524	22,903	27,462
Others	25	(266)	(296)	(305)	(314)
Total	19,355	30,453	27,393	27,055	31,898
Gross Profit Margins (%)					
Alumina	16.4	23.5	24.9	26.4	27.9
Aluminum products	23.8	27.6	20.9	21.3	24.2
Others	4.0	(38.6)	(38.6)	(38.6)	(38.6)
Total	22.5	26.6	21.1	21.6	24.3

Source: Company, DBS HK

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Income Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	86,145	114,491	129,983	125,010	131,466
Cost of Goods Sold	(66,789)	(84,038)	(102,589)	(97,954)	(99,569)
Gross Profit	19,355	30,453	27,393	27,055	31,898
Other Opng (Exp)/Inc	(4,452)	(6,234)	(7,726)	(8,116)	(9,328)
Operating Profit	14,903	24,219	19,667	18,940	22,570
Other Non Opg (Exp)/Inc	1,793	1,899	1,899	1,899	1,899
Associates & JV Inc	515	62	10	10	10
Net Interest (Exp)/Inc	(4,506)	(3,626)	(3,008)	(3,136)	(3,136)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	12,704	22,554	18,569	17,713	21,343
Tax	(2,260)	(5,705)	(4,697)	(4,481)	(5,399)
Minority Interest	51	(775)	(638)	(609)	(734)
Preference Dividend	0	0	0	0	0
Net Profit	10,496	16,073	13,234	12,623	15,210
Net Profit before Except.	10,496	16,073	13,234	12,623	15,210
EBITDA	23,898	32,830	28,057	27,238	30,784
Growth					
Revenue Gth (%)	2.3	32.9	13.5	(3.8)	5.2
EBITDA Gth (%)	12.7	37.4	(14.5)	(2.9)	13.0
Opg Profit Gth (%)	20.5	62.5	(18.8)	(3.7)	19.2
Net Profit Gth (%)	72.2	53.1	(17.7)	(4.6)	20.5
Margins & Ratio					
Gross Margins (%)	22.5	26.6	21.1	21.6	24.3
Opg Profit Margin (%)	17.3	21.2	15.1	15.2	17.2
Net Profit Margin (%)	12.2	14.0	10.2	10.1	11.6
ROAE (%)	15.6	21.1	15.8	14.1	16.0
ROA (%)	5.8	8.7	7.0	6.6	7.7
ROCE (%)	8.2	11.9	9.6	8.9	10.2
Div Payout Ratio (%)	53.2	59.3	48.0	48.0	48.0
Net Interest Cover (x)	3.3	6.7	6.5	6.0	7.2

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	64,750	63,442	62,461	61,573	60,768
Invt in Associates & JVs	6,681	6,065	6,065	6,065	6,065
Other LT Assets	12,666	15,386	15,386	15,386	15,386
Cash & ST Invt	47,007	50,851	47,571	55,572	62,036
Inventory	19,718	22,705	25,894	24,724	25,132
Debtors	28,620	29,972	32,735	31,894	32,986
Other Current Assets	2,089	0	0	0	0
Total Assets	181,531	188,421	190,112	195,214	202,372
ST Debt	45,552	24,610	24,610	24,610	24,610
Creditors	25,483	30,215	25,876	25,226	25,452
Other Current Liab	2,317	8,242	8,242	8,242	8,242
LT Debt	24,829	24,916	24,916	24,916	24,916
Other LT Liabilities	6,549	8,000	8,000	8,000	8,000
Shareholder's Equity	71,196	81,308	86,700	91,843	98,041
Minority Interests	5,606	11,131	11,769	12,379	13,112
Total Cap. & Liab.	181,531	188,421	190,112	195,214	202,372
Non-Cash Wkg. Capital	22,627	14,220	24,511	23,151	24,423
Net Cash/(Debt)	(23,374)	1,326	(1,954)	6,047	12,510
Debtors Turn (avg days)	86.7	61.7	57.8	62.9	60.2
Creditors Turn (avg days)	73.1	67.0	46.0	47.0	46.7
Inventory Turn (avg days)	113.6	92.1	92.1	92.1	92.1
Asset Turnover (x)	0.5	0.6	0.7	0.6	0.7
Current Ratio (x)	1.3	1.6	1.8	1.9	2.1
Quick Ratio (x)	1.0	1.3	1.4	1.5	1.6
Net Debt/Equity (X)	0.3	CASH	0.0	CASH	CASH
Net Debt/Equity ex MI (X)	0.3	CASH	0.0	CASH	CASH
Capex to Debt (%)	7.5	12.1	11.1	11.1	11.1
Z-Score (X)	1.6	1.7	1.7	1.7	NA

Source: Company, DBS HK

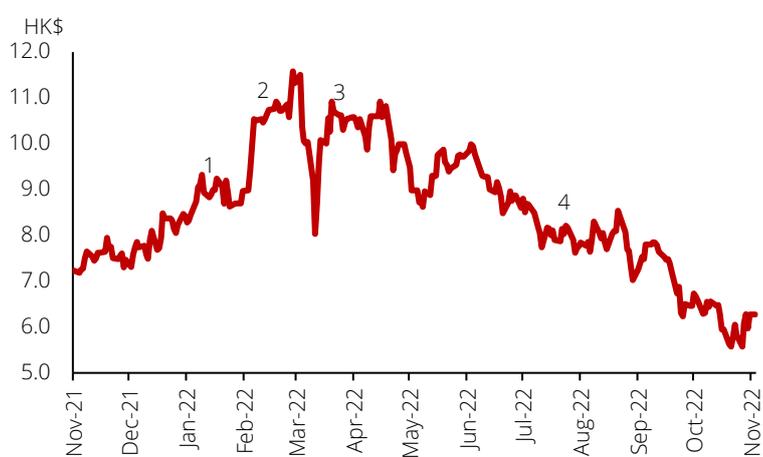
Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	12,704	22,554	18,569	17,713	21,343
Dep. & Amort.	6,688	6,516	6,481	6,388	6,305
Tax Paid	(2,430)	(5,001)	(4,697)	(4,481)	(5,399)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(3,414)	376	(10,291)	1,360	(1,272)
Other Operating CF	4,231	4,204	0	0	0
Net Operating CF	17,779	28,650	10,062	20,981	20,977
Capital Exp.(net)	(5,268)	(5,999)	(5,500)	(5,500)	(5,500)
Other Invt.(net)	(113)	(454)	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(1,593)	990	0	0	0
Net Investing CF	(6,974)	(5,463)	(5,500)	(5,500)	(5,500)
Div Paid	(3,768)	(7,288)	(7,842)	(7,480)	(9,013)
Chg in Gross Debt	(6,365)	(24,918)	0	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	2,984	12,809	0	0	0
Net Financing CF	(7,150)	(19,396)	(7,842)	(7,480)	(9,013)
Currency Adjustments	0	0	0	0	0
Chg in Cash	3,655	3,790	(3,280)	8,001	6,464
Opg CFPS (RMB)	2.47	3.12	2.11	2.03	2.30
Free CFPS (RMB)	1.46	2.50	0.47	1.60	1.60

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1	17-Jan-22	HK\$8.93	HK\$15.00	BUY
2	15-Feb-22	HK\$10.54	HK\$15.00	BUY
3	21-Mar-22	HK\$10.08	HK\$14.50	BUY
4	27-Jul-22	HK\$8.14	HK\$12.00	BUY

Source: DBS HK

Analyst: Duncan Chan

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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