

**BUY (Maintain)**

# China Hongqiao (1378 HK)

## Re-rating to continue on strong fundamentals

CHQ's FY20 earnings was stronger than our estimates on better-than-expected effective tax rate. Looking ahead in 2021E, we think CHQ's fundamentals are solidified as 1) debt repayment is on track; 2) share placement removed short-term overhang for further dilution; and 3) aluminum price stays strong for limited supply. We lift our FY21/22E aluminum ASP by 7.7%/6.7%, which boost earnings projection by 19.1%/13.0%. We think aluminum ASP still has upside given that current price is still 6.8% higher than our assumption in 2021E. **We lift TP by 31.9% to HK\$15.00. Reiterate BUY.**

- **FY20 results beat on effective tax rate.** CHQ posted FY20 results with net profit of RMB10.5bn in early Mar. The earnings increased by 72.2% YoY, significantly higher than positive profit alert guidance (RMB9bn). CHQ's FY20 results was largely in line with our previous projections with surprise came from effective tax rate. The ratio declined 8.6ppt to 17.8% due to compensable losses linked to historical assets provision in 2017-19. CHQ declared HK50 cents final dividends for FY20. Aggregating with interim dividend of HK15 cents, CHQ increased full year dividend payout to 44%.
- **On track to debt repayment schedule.** CHQ made disclosures in details for its debt repayment updates. The Company had fully repaid mature debt in Jan and Feb. By end-2020, CHQ had more than RMB45.4bn cash on hand and sufficient line of credit. We believe CHQ is on track to its debt repayment schedule.
- **Share placement to enhance market confidence and to boost liquidity.** CHQ made another share placement on 11 Mar for 243mn share with net proceed of HK\$2.32bn. Together with previous fund raising through placement and CB issuance, CHQ had raised more than HK\$6.6bn. We are positive on those fund raising activities, since 1) successful fund raising implied strong market interest on CHQ; and 2) it helps resolved market concerns for trading turnover.
- **Fundamentals support aluminum price to stand high.** In Mar, we are more confident on aluminum price due to tightened supply release on the back of aluminum capacity control in Inner Mongolia. The capacity control is driven by central government's intensifying requirements for carbon intensity reduction, while Inner Mongolia failed its KPIs in 2019. Looking forward, in view of increasing national requirements for carbon peaking by 2030 in China, we think new captive power plant based aluminum capacity expansion will be limited, while CHQ's hydro-power based capacity may gain some edges. We lift our aluminum ASP outlook by 5.7%/6.7% in 2021/22E to RMB16,000/tonne.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	84,179	86,145	96,259	100,974	102,602
Net income (RMB mn)	6,095	10,496	13,951	14,247	15,114
EPS (RMB)	0.71	1.22	1.55	1.56	1.66
EPS CHG (%)	14.0	72.3	27.0	0.8	6.1
Consensus EPS (RMB)	n/a	1.12	1.60	1.77	2.26
P/E (x)	13.6	7.9	6.2	6.2	5.8
P/B (x)	0.87	0.80	0.71	0.65	0.60
Dvd Yield (%)	2.90	5.55	7.51	7.77	8.25
ROE	9.6	15.2	17.2	15.9	15.4
Net gearing (%)	56.5	39.7	21.7	9.7	N.C.

Source: Company data, CMBIS estimates, Bloomberg

Target Price **HK\$15.00**  
 (Previous TP **HK\$11.37**)  
 Up/Downside **+27.8%**  
 Current Price **HK\$11.74**

### China Aluminum Sector

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Mkt. Cap. (HK\$ mn)	107,085
Avg. 3mths t/o (HK\$ mn)	339.14
52W High/Low (HK\$)	13/2.64
Total Issued Shares (mn)	9,121
Source: Bloomberg	

### Shareholding Structure

Hongqiao Holdings	66.62%
CITIC Group	9.62%
Freefloat	23.66%

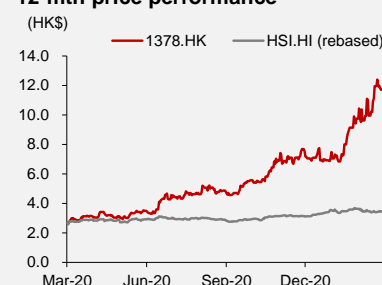
Source: HKEx, Bloomberg

### Share performance

	Absolute	Relative
1-mth	12.5%	18.0%
3-mth	63.5%	47.9%
6-mth	151.1%	106.2%
12-mth	333.3%	242.1%

Source: Bloomberg

### 12-mth price performance



Source: Wind

**Auditor: Shinewing (HK)**

### Related report:

China Hongqiao (1378 HK Initiation) -  
 Sail through the winds and waves – 8  
 Feb 2021 ([link](#))

- **Secondary aluminum business to contribute future capacity growth.** CHQ formed JV with Scholz Recycling Group for developing secondary aluminum business in Shandong in Sep 2020. The JV plans to have long term annual capacity to process 50k units end-of-life vehicles and to produce 500k tonnes green aluminum. The JV kicked off construction in Feb 2021, and plans to have phase capacity to commence operation in 2022. We think the JV will boost CHQ's secondary aluminum business, and contribute aluminum sales volume growth in the near future.
- **Revise earnings up by 23.3%/27.3% in 2021/22E.** We trim our product output assumptions by 9.9%/11.8% in 2021/22E on revised aluminum and aluminum fabrication mix. Based on our updated ASP outlook, however, we lift CHQ's earnings outlook by 19.1%/13.0% in 2021/22E to RMB13.95/14.25bn. Our earnings model is highly sensitive to aluminum price and coal price (see Fig. 4). We estimate 1) every 1% increase in aluminum price will bring c.3.6% earnings growth at current level; and 2) every 1% coal price decline will bring c.1.2% net profit growth. Aluminum price is now 6.8% higher than ASP assumption.
- **Reiterate BUY.** CHQ's share price had reached our TP of HK\$11.37 since initiation in early Feb. We think strong market commodity sentiment and good performing aluminum price are the key reasons driving re-rating. In view of strong earnings outlook and solid fundamentals of supply-demand balance, we lift our target multiple slightly to above 5-yr average at 8.0x forward PER. Our new TP for CHQ is HK\$15.00 per share. Trading at 6.2x PER with potential dividend yield of 6.8% in 2021E, we still find CHQ's valuation very attractive. Reiterate BUY.
- **Risks:** 1) unfavorable carbon trading update; 2) aluminum price decline on economy slow down.

Figure 1: FY20 earnings summary and CMBIS comments

RMB mn, YE Dec 31	2019	2020A	YoY	2020E	Actual vs. CMBIS est.	CMBIS comments
Revenue	84,179	86,145	2.3%	87,362	-1.4%	In line with CMBIS est.
Costs of good sold	(67,715)	(66,789)	-1.4%	(68,082)	-1.9%	In line with CMBIS est.
Gross profit	16,464	19,355	17.6%	19,280	0.4%	In line with CMBIS est.
Gross profit margin	19.6%	22.5%	2.9ppt	22.1%	0.4ppt	
Other income and gains	3,141	2,701	-14.0%	2,225	21.4%	More scrap sales than CMBIS expected
Selling and distribution expenses	(449)	(400)	-10.9%	(437)	-8.5%	
Administrative expenses	(3,646)	(4,052)	11.1%	(3,757)	7.9%	CHQ had more maintenance in 2020
Other expenses	(2,167)	(617)	-71.5%	(630)	-2.2%	
Finance costs	(5,220)	(4,506)	-13.7%	(4,396)	2.5%	
Change in fair value of financial instruments	138	(291)	-310.9%	130	n/a	
Share of profits of associates	509	515	1.0%	593	-13.3%	
Loss on disposal of a subsidiary	-	-	n/a	-	n/a	
Profit before tax	8,771	12,704	44.8%	13,009	-2.3%	
Income tax paid	(2,316)	(2,260)	-2.4%	(3,252)	-30.5%	Income tax was the key variance from our est.
effective tax rate	26.4%	17.8%	-8.6ppt	25.0%	-7.2ppt	
Profit for the year	6,455	10,445	61.8%	9,757	7.1%	
Minority interests	360	(51)	-114.2%	488	-110.5%	
Net profit	6,095	10,496	72.2%	9,269	13.2%	Net profit beat CMBIS est.
Net profit margin	7.2%	12.2%	4.9ppt	10.6%	1.6ppt	

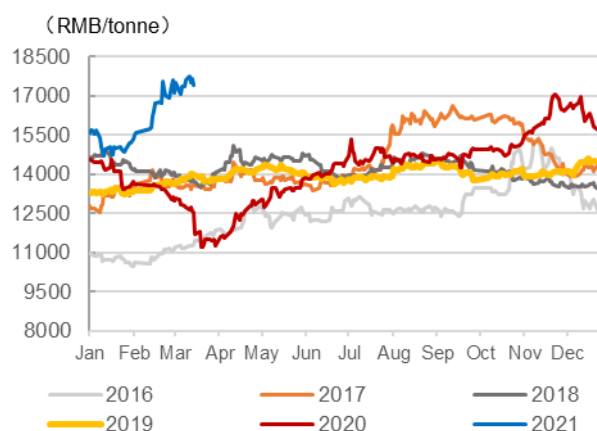
Source: Company data, CMBIS estimates

Figure 2: China Shanghai Changjiang Aluminum Spot Price experienced rally after CNY holidays



Source: Antaike, Bloomberg, CMBIS

Figure 3: YoY Aluminum price movement



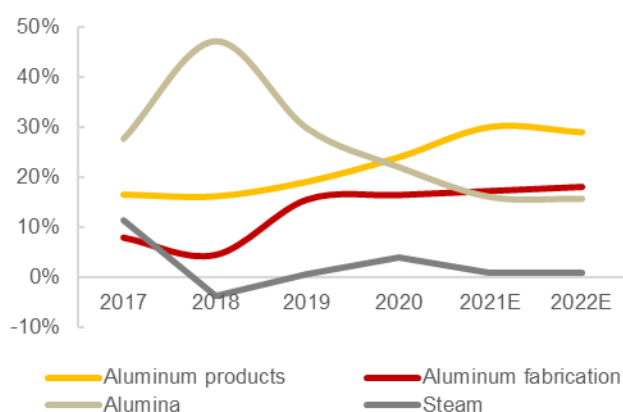
Source: Antaike, Bloomberg, CMBIS

Figure 4: Our sensitivity analysis on CHQ's earnings in 2021E (RMB mn) in different aluminium and coal price combination

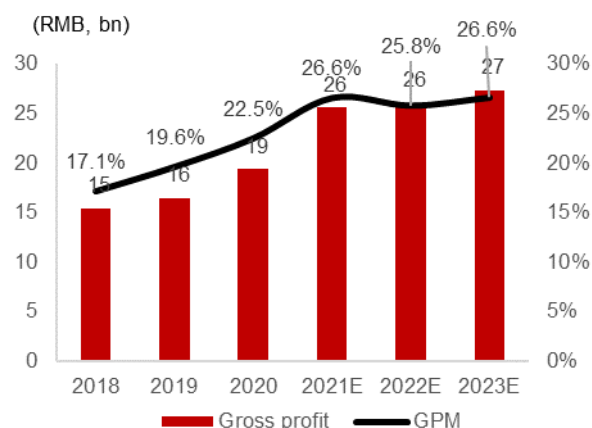
		Aluminum price(RMB/tonnes, VAS incl.)											
		-5%	-4%	-3%	-2%	-1%	Base point	1%	2%	3%	4%	5%	
		15,330	15,492	15,653	15,974	16,137	16,300	16,463	16,626	16,789	16,952	17,115	
Coal price (RMB/tonne, VAT incl.)	-5%	608	11,473	11,968	12,463	13,448	13,948	14,448	14,948	15,448	15,948	16,448	16,948
	-4%	614	11,374	11,869	12,363	13,348	13,848	14,348	14,848	15,348	15,848	16,348	16,848
	-3%	621	11,274	11,769	12,264	13,249	13,749	14,249	14,749	15,249	15,749	16,249	16,749
	-2%	627	11,175	11,670	12,165	13,150	13,650	14,150	14,650	15,150	15,650	16,150	16,650
	-1%	634	11,075	11,570	12,065	13,050	13,550	14,050	14,550	15,050	15,550	16,050	16,550
	Base point	640	10,976	11,471	11,966	12,951	13,451	13,951	14,451	14,951	15,451	15,951	16,451
	1%	646	10,877	11,372	11,867	12,852	13,352	13,852	14,352	14,852	15,351	15,851	16,351
	2%	659	10,676	11,171	11,666	12,651	13,151	13,651	14,151	14,651	15,151	15,651	16,151
	3%	679	10,369	10,864	11,359	12,344	12,844	13,344	13,844	14,344	14,844	15,344	15,844
	4%	706	9,947	10,442	10,937	11,922	12,422	12,922	13,422	13,922	14,422	14,922	15,422
	5%	742	9,399	9,894	10,389	11,374	11,874	12,374	12,874	13,374	13,874	14,373	14,873

Source: CMBIS estimates

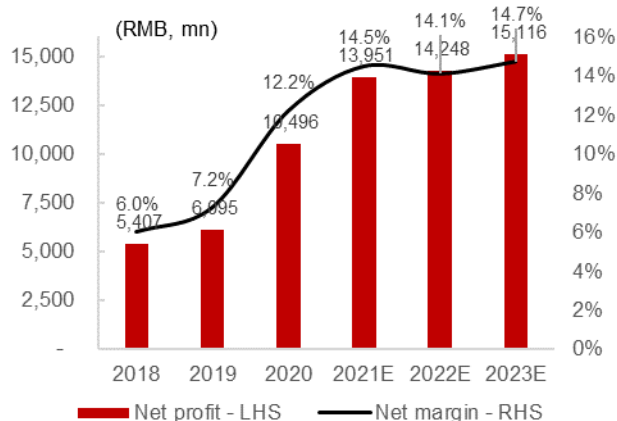


**Figure 5: CHQ's segment GPM**

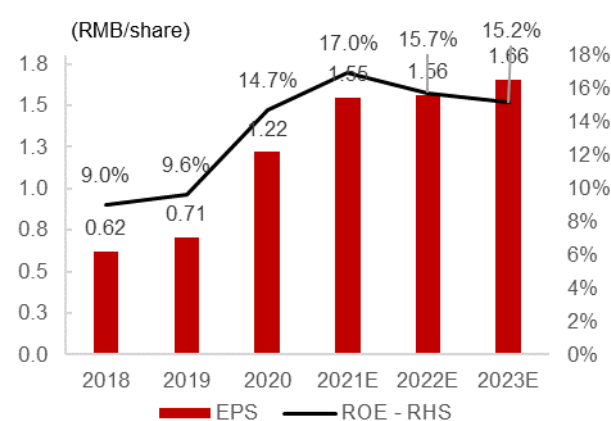
Source: Company data, CMBIS estimates

**Figure 6: CHQ's overall GP vs. GPM**

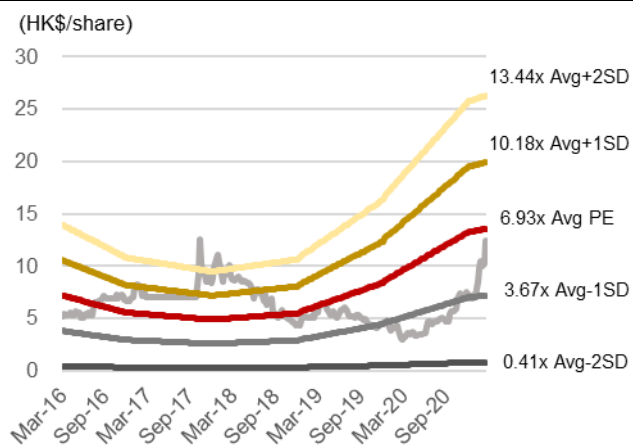
Source: Company data, CMBIS estimates

**Figure 7: Net profit vs. Net profit margin**

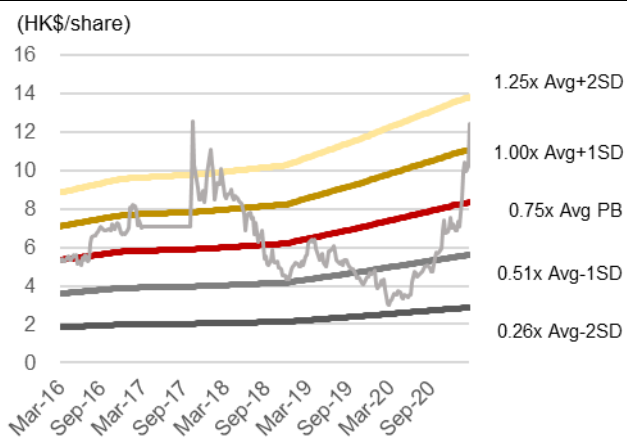
Source: Company data, CMBIS estimates

**Figure 8: EPS vs. ROE**

Source: Company data, CMBIS estimates

**Figure 9: 5-Yr PE Band**

Source: Bloomberg, CMBIS

**Figure 10: 5-Yr PB Band**

Source: Bloomberg, CMBIS

Figure 11: Our key assumptions and projections

	2018	2019	2020	2021E	2022E	2023E
<b>Aluminum product</b>						
Production (k tonnes)	6,282	5,644	5,622	5,900	6,300	6,400
Sales (k tonnes)	5,865	5,058	5,060	5,095	5,420	5,446
Sales to production rate	93%	90%	90%	86%	86%	85%
ASP (RMB/t, VAT excl.)	12,194	12,236	12,501	14,393	14,128	14,128
Revenue (RMB mn)	71,516	61,891	63,257	71,866	75,046	75,408
<b>Aluminum fabrication</b>						
Production (k tonnes)	503	630	622	684	753	828
Sales (k tonnes)	493	623	601	671	738	811
Sales to production rate	98%	99%	98%	98%	98%	98%
ASP (RMB/t, VAT excl.)	14,470	14,607	14,877	17,127	16,812	16,812
Revenue (RMB mn)	7,135	9,105	8,781	11,719	12,653	13,918
<b>Alumina</b>						
Production (k tonnes)	14,403	14,650	14,650	15,150	15,650	15,650
Sales (k tonnes)	4,090	5,277	6,734	7,071	7,424	7,424
ASP (RMB/t, VAT excl.)	2,700	2,373	2,078	2,124	2,124	2,124
Revenue (RMB mn)	11,045	12,521	13,487	12,014	12,615	12,615
Internal consumption(k tonnes)	11,261	9,711	9,715	9,783	10,407	10,457
External procurement(k tonnes)	451	284	828	725	1,141	1,186
Self-sufficiency rate	87.2%	89.1%	90.0%	90.0%	90.0%	90.0%
<b>Material costs</b>						
Coal costs(RMB/t VAT excl.)	543	515	509	566	566	566
Blended Bauxite costs (RMB/t VAT excl.)	418	403	353	361	364	364
Pre-cultured anode (RMB/t, VAT excl.)	3,151	2,868	2,676	2,986	2,986	2,986
<b>Aluminum costs structure (RMB/tonne)</b>						
Electricity costs	3,995	3,912	3,814	4,010	3,950	3,785
Alumina costs	3,791	3,643	3,372	3,422	3,437	3,439
Pre-cultured anode	1,512	1,377	1,285	1,433	1,433	1,433
Others	925	969	981	994	1,006	1,019

Source: Company data, CMBIS estimates

Figure 12: Earnings revision

	Old		New		Change(%)	
	2021E	2022E	2021E	2022E	2021E	2022E
Aluminum sales volume (k tonnes)	5,655	6,143	5,095	5,420	-9.9%	-11.8%
ASP (RMB/tonne, VAT incl.)	15,138	15,000	16,300	16,000	7.7%	6.7%
Revenue (RMB mn)	96,745	103,994	96,259	100,974	-0.5%	-2.9%
Net Income (RMB mn)	11,713	12,613	13,951	14,247	19.1%	13.0%
EPS (RMB)	1.32	1.42	1.55	1.56	17.5%	9.9%

Source: CMBIS estimates

## Financial Statements

### Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>84,179</b>	<b>86,145</b>	<b>96,259</b>	<b>100,974</b>	<b>102,602</b>
Aluminum products	61,891	63,257	71,866	75,046	75,408
Aluminum fabrication	9,105	8,781	11,719	12,653	13,918
Alumina	12,521	13,487	12,014	12,615	12,615
Steam	663	619	661	661	661
<b>COGS</b>	<b>(67,715)</b>	<b>(66,789)</b>	<b>(70,676)</b>	<b>(74,925)</b>	<b>(75,299)</b>
Gross profit	16,464	19,355	25,583	26,049	27,303
Other income and gains	3,141	2,701	2,688	2,777	2,891
S&D expenses	(449)	(400)	(481)	(505)	(513)
Admin expenses	(3,646)	(4,052)	(4,139)	(4,342)	(4,412)
Other expenses	(2,167)	(617)	(544)	(551)	(554)
Financial costs	(5,220)	(4,506)	(4,084)	(3,806)	(3,645)
Change in fair value	138	(291)	130	130	130
Share profits	509	515	637	674	703
Subsidy disposal loss	-	-	-	-	-
<b>Profit Before Tax</b>	<b>8,771</b>	<b>12,704</b>	<b>19,789</b>	<b>20,426</b>	<b>21,904</b>
Income tax	(2,316)	(2,260)	(4,947)	(5,107)	(5,476)
Less: Minority Interest	360	(51)	890	1,072	1,314
<b>Net profit</b>	<b>6,095</b>	<b>10,496</b>	<b>13,951</b>	<b>14,247</b>	<b>15,114</b>

### Cash flow Summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Profit before tax</b>	<b>8,771</b>	<b>12,704</b>	<b>19,789</b>	<b>20,427</b>	<b>21,907</b>
Interest payment	5,220	4,506	4,084	3,806	3,645
DD&A	7,413	7,565	7,743	7,954	8,192
Change in WC	1,323	(5,372)	(6,021)	(1,598)	(85)
Tax adjustments	(2,484)	(2,882)	(5,336)	(5,081)	(5,537)
Others	(5,701)	1,258	483	(1,657)	(2,487)
<b>Net cash from operation</b>	<b>14,541</b>	<b>17,779</b>	<b>20,742</b>	<b>23,851</b>	<b>25,634</b>
Capex & investments	(11,912)	(5,921)	(3,549)	(5,483)	(5,923)
Others	4,216	(1,053)	-	-	-
<b>Net cash from investment</b>	<b>(6,263)</b>	<b>(6,974)</b>	<b>(3,549)</b>	<b>(5,483)</b>	<b>(5,923)</b>
Equity raised	(379)	1,007	1,898	-	-
Change of Debts	511	(3,831)	(8,000)	(1,500)	(4,000)
Dividend paid	(1,921)	(3,833)	(4,920)	(5,887)	(6,094)
Interest payment	(5,220)	(4,506)	(4,084)	(3,806)	(3,645)
Others	(4,808)	4,014	890	1,072	1,314
<b>Net cash from financing</b>	<b>(11,816)</b>	<b>(7,150)</b>	<b>(14,216)</b>	<b>(10,121)</b>	<b>(12,424)</b>
Net change in cash	(3,537)	3,655	2,976	8,248	7,287
Cash at beginning	45,380	41,857	44,887	47,864	56,111
FX change	13	(625)	-	-	-
<b>Cash at the end</b>	<b>41,857</b>	<b>44,887</b>	<b>47,864</b>	<b>56,111</b>	<b>63,398</b>
Less: pledged cash	-	-	-	-	-
<b>Cash at balance sheet</b>	<b>41,857</b>	<b>45,465</b>	<b>47,864</b>	<b>56,111</b>	<b>63,398</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Non-current Assets</b>	<b>86,416</b>	<b>81,598</b>	<b>79,792</b>	<b>77,284</b>	<b>75,102</b>
Fixed Assets	71,019	64,750	63,458	60,112	56,941
Right-of-use assets	5,152	5,647	5,549	5,750	5,950
Interests in associates	4,723	6,681	5,879	6,553	7,257
Others	5,521	4,520	4,906	4,869	4,954
<b>Current Assets</b>	<b>92,657</b>	<b>95,345</b>	<b>105,964</b>	<b>116,717</b>	<b>124,231</b>
Cash and cash	41,857	45,465	47,864	56,111	63,398
Trade and bills	21,451	19,493	24,255	25,443	25,648
Prepayments	6,075	9,126	9,145	9,593	9,747
Inventories	21,847	19,718	23,323	24,725	24,849
Others	1,427	1,542	1,377	845	589
<b>Current Liabilities</b>	<b>65,319</b>	<b>73,351</b>	<b>59,677</b>	<b>55,241</b>	<b>42,081</b>
Account Payables	18,216	13,377	14,135	14,985	15,060
Other payables	13,380	12,106	13,428	13,486	13,554
ST borrowings	31,971	45,577	29,797	24,429	11,102
Others	1,753	2,291	2,316	2,341	2,366
<b>Non-Current Liabilities</b>	<b>47,119</b>	<b>30,163</b>	<b>40,046</b>	<b>43,294</b>	<b>51,449</b>
LT borrowings	45,568	28,131	37,839	41,039	49,106
Derivative component of	280	550	578	606	637
Deferred income	549	582	611	641	674
Others	722	900	1,018	1,007	1,033
<b>Total net assets</b>	<b>66,016</b>	<b>76,802</b>	<b>88,621</b>	<b>98,054</b>	<b>108,390</b>
<b>Minority Interests</b>	<b>2,852</b>	<b>5,606</b>	<b>6,496</b>	<b>7,568</b>	<b>8,883</b>
<b>Shareholder's equity</b>	<b>63,164</b>	<b>71,196</b>	<b>82,125</b>	<b>90,486</b>	<b>99,507</b>

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Sales mix (%)</b>					
Aluminum products	73.5%	73.4%	74.7%	74.3%	73.5%
Aluminum fabrication	10.8%	10.2%	12.2%	12.5%	13.6%
Alumina	14.9%	15.7%	12.5%	12.5%	12.3%
Steam	0.8%	0.7%	0.7%	0.7%	0.6%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>P&amp;L ratios (%)</b>					
Gross profit margin	19.6	22.5	26.6	25.8	26.6
Operating margin	16.6	20.0	24.8	24.0	24.9
Net margin	7.2	12.2	14.5	14.1	14.7
Effective tax rate	26.4	17.8	25.0	25.0	25.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.43	1.33	1.78	2.11	2.95
Inventory turnover days	112.3	114.5	111.1	117.0	120.2
Creditor's turnover	86.6	86.7	82.9	89.8	90.9
Debtors turnover days	94.0	87.0	71.0	70.9	72.8
Liabilities/Assets (%)	63.2	57.7	52.9	50.1	46.3
Net gearing ratio (%)	56.5	39.7	21.7	8.9	-3.21
<b>Returns (%)</b>					
ROE	9.6	14.7	17.0	15.7	15.2
ROA	3.4	5.8	7.4	7.2	7.5
<b>Per share</b>					
EPS (RMB)	0.71	1.22	1.55	1.56	1.66
DPS (HK\$)	0.34	0.65	0.88	0.91	0.97
BVPS (RMB)	7.37	8.02	9.00	9.85	10.77

Source: Company data, CMBIS estimates



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