

China Hongqiao (1378 HK)

Attractive valuation with high dividend yield

China Hongqiao announced its FY21 full-year results. Top-line rose by 33% YoY to RMB114.5bn (2H21 +34% YoY) while bottom-line increased by 53% YoY to RMB16.1bn (2H21 +4% YoY). The Company declared a final dividend of HK\$0.6 per share, achieving a record high of 50% payout ratio. We believe that China's aluminum industry will benefit from the post-COVID-19 recovery supported by proactive macro policy and limited new capacity released in 2022E. We expect the aluminum price will be lingering at a high level throughout the year. We resume coverage on the Company with a BUY rating and set TP at HK\$15.3 (based on 6.0x 2022E P/E) with 43.7% upside. The implied dividend yield reached 12.1% given current price, which is deemed to be very attractive in the volatile market environment.

- The Company posed excellent performance in 2021.** In 2021, China aluminum industry continued to exercise the supply-side structural reform together with short-term restrictions on electricity and energy consumption. As a result, the average price of SHFE three-month aluminum futures was approximately RMB18,898/tonne (including VAT) in 2021, an increase of 37.3% YoY. In 2021, benefiting from rising aluminum prices and sustainable cost advantage, CHQ achieved a full-year gross profit margin of 26.6% (2H21 23.7%), +4.1ppt YoY. The Company's S&D expense ratio remained stable at 0.5% while the administrative expense ratio was up by 0.28ppt to 4.99% due to 1) an increase in the maintenance expense and 2) an increase in R&D expense. The Company successfully reduced its debt ratio by 6.8ppt to 50.9% in 2021, resulting in a 19.5% YoY drop of financial expenses to RMB3.6mn. The Company's net profit was recorded at RMB16.1mn with an NPM of 14.0%, +1.9ppt YoY in 2021.
- Rising aluminum prices in 2022E among global and domestic inflation.** Affected by the conflict in Russia and Ukraine, the rising cost of natural gas has led to high production costs for overseas aluminum manufacturers. LME monthly aluminum price has risen by 28% YTD. For China market, we observed the slower-than-expected production capacity resumption of electrolytic aluminum which was disrupted by local energy restriction in 2H21. In addition, the Omicron variant has caused a new round of production suspension. However, the steady growth of domestic demand is still backed by pro-growth policy and strong demand for NEV. As a result, the de-inventory process has happened in early Mar 2022 and we expect the aluminum prices to remain at a high level throughout the year. Obviously, CHQ will continue to enjoy the high price environment.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	86,145	114,491	117,054	118,479	120,747
YoY (%)	2.33	32.91	2.24	1.22	1.91
Net Income (RMB mn)	10,496	16,073	19,254	20,590	22,669
EPS (RMB)	1.22	1.77	2.11	2.26	2.49
EPS CHG (%)	72.3	45.1	19.1	6.9	10.1
Consensus EPS (RMB)	1.12	1.60	2.21	2.24	2.36
PE (x)	7.2	4.9	4.1	3.9	3.5
PB (x)	0.80	0.72	0.63	0.56	0.50
Yield (%)	6.12	9.9	12.1	12.9	14.2
ROE (%)	15.2	19.9	20.8	19.8	19.5
Net gearing (%)	39.7	7.7	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Resume)

Target Price HK\$15.3
Up/Downside +43.7%
Current Price HK\$10.6

China Aluminum Sector

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Stock Data

Mkt Cap (HK\$ mn)	98,280
Avg 3 mths t/o (HK\$ mn)	206.51
52w High/Low (HK\$)	11.9/6.88
Equity share – 1378.HK	9,254

Source: Wind

Shareholding Structure

Hongqiao Holdings	66.62%
CITIC Group	11.48%

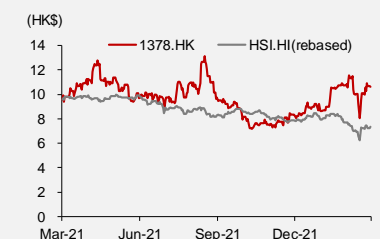
Source: HKEx, Bloomberg

Share Performance

	Absolute	Relative
1-mth	-2.2%	2.4%
3-mth	27.5%	36.9%
6-mth	8.7%	22.8%

Source: Wind

12-mth Price Performance



Source: Wind

Auditor: Shinewing (HK)

- **We expect CHQ to enlarge advantages on production capacity and cost structure.** The second phase of the alumina project in Indonesia has been put into production by the end of 2021, further expanding its advantage on alumina capacity. Meanwhile, CHQ continues the process of inter-location capacity replacement which will make full use of the electricity price advantage in Yunnan and bring incremental profit through cost-saving. In addition, the Phase I project, operated by the JV of CHQ and Chiho Group (976 HK), has been put into production at the end of 2021 and is expected to achieve a full ramp-up in 2022E (50,000 vehicles recycling and 200,000 tons of recycled aluminum). We believe CHQ can not only obtain corresponding profits through this project but also gain know-how and first-mover advantages in the recycled aluminum and automobile recycling sector.
- **We believe that CHQ has potential to further reduce its debt ratio.** Benefiting from its bottom-line performance and strong operation efficiency, the Company achieved an operating cash inflow of RMB28.7bn in 2021, the largest since 2018, further improving its financial conditions. Fully taking advantage of the domestic credit cycle, CHQ has newly issued a total of RMB2.0bn domestic short-/medium-term bonds in 2021 with a lower interest rate, further reducing its weighted average interest rate. We expect CHQ to take advantage of the high aluminum price environment and will use its strong operating cash flow to further reduce its debt level, which thereby cut back the financial expenses.
- **Attractive valuation with high dividend yield.** We believe that the market has not yet priced in the upward momentum of aluminum prices throughout 2022E, and therefore underestimated the profitability of the overall industry and CHQ. We forecast the Company to achieve a net profit of RMB19.3bn in 2022E, +19.7% YoY. In addition, we believe the Company will stick to the high payout strategy with 12.1% of dividend yield in 2022E at the current price. At the same time, we believe in the early period of the Fed tightening cycle, the resource sector and value names are expected to outperform driven by the sentiment switch. The Company is currently trading at 4.1x 2022E with limited downside risk. We believe CHQ has the upside potential to reach a Davis double-killing in the next 12 months. We resume coverage on CHQ with a TP of HK\$15.3 (based on 6.0x 2022E P/E).

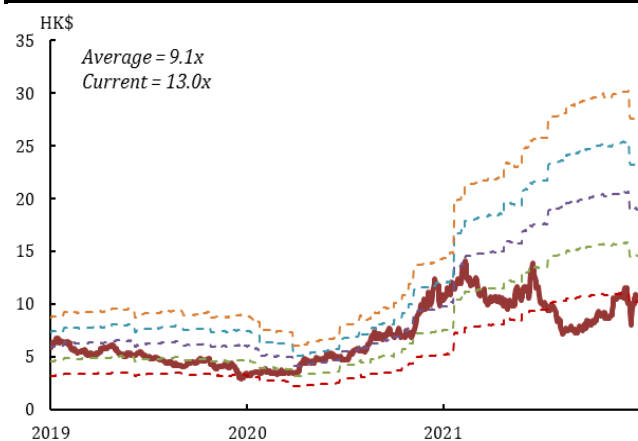
Earning Summary

Figure 1: Financial summary

YE Dec-31 (RMB, mn)	1H20	2H20	FY20	1H21	2H21	FY21	1H21 YoY	2H21 YoY	FY21 YoY	2H21E	Act vs. Est.
Revenue	39,939	46,206	86,145	52,481	62,010	114,491	31.4%	34.2%	32.9%	55,702	11.3%
Aluminum products	29,042	34,215	63,257	38,356	45,957	84,313	32.1%	34.3%	33.3%	42,946	n/a
Aluminum fabrication	4,134	4,647	8,781	5,779	6,745	12,524	39.8%	45.1%	42.6%	7,282	n/a
Alumina	6,391	7,095	13,487	7,921	9,046	16,967	23.9%	27.5%	25.8%	5,238	n/a
Steam	370	249	619	424	263	687	14.5%	5.6%	10.9%	236	n/a
					18.5%					0	
Costs of good sold	(33,470)	(33,319)	(66,789)	(36,745)	(47,293)	(84,038)	9.8%	41.9%	25.8%	(38,814)	21.8%
Gross profit	6,468	12,887	19,355	15,736	14,717	30,453	143.3%	14.2%	57.3%	16,887	-12.9%
Gross profit margin	16.2%	27.9%	22.5%	30.0%	23.7%	26.6%	13.8ppt	-4.2ppt	4.1ppt	30.3%	-0.3ppt
Other income and gains	1,076	1,625	2,701	1,506	2,201	3,707	40.0%	35.4%	37.2%	1,345	63.6%
Selling and distribution expenses	(153)	(247)	(400)	(260)	(265)	(526)	70.7%	7.3%	31.5%	(281)	-5.4%
Administrative expenses	(1,858)	(2,194)	(4,052)	(2,552)	(3,157)	(5,708)	37.3%	43.9%	40.9%	(2,100)	50.3%
Other expenses	(362)	(254)	(617)	(104)	(1,586)	(1,691)	-71.3%	524.1%	174.2%	(258)	514.6%
Finance costs	(2,211)	(2,295)	(4,506)	(1,890)	(1,736)	(3,626)	-14.5%	-24.3%	-19.5%	(2,055)	-15.5%
Change in fair value	86	(377)	(291)	(1,166)	1,049	(117)	-1452.6%	-377.9%	-59.9%	(34)	-3141.6%
Share of profits of associates	354	160	515	12	50	62	-96.7%	-68.9%	-88.0%	352	-85.8%
Loss on disposal of a subsidiary	-	-	-	(5)	5	-	n/a	n/a	n/a	5	0.0%
Profit before tax	3,400	9,304	12,704	11,277	11,277	22,554	231.7%	21.2%	77.5%	13,862	-18.6%
Income tax	(596)	(1,664)	(2,260)	(2,853)	(2,852)	(5,705)	379.0%	71.4%	152.5%	(3,432)	-16.9%
effective tax rate	17.5%	17.9%	17.8%	25.3%	25.3%	25.3%	7.8ppt	7.4ppt	7.5ppt	24.8%	0.5ppt
Profit for the period	2,804	7,640	10,445	8,424	8,425	16,849	200.4%	10.3%	61.3%	10,430	-19.2%
Minority interests	(27)	(24)	(51)	281	494	775	-1127.4%	-2175.5%	-1615.0%	850	-41.9%
Net profit	2,832	7,664	10,496	8,143	7,931	16,073	187.5%	3.5%	53.1%	9,580	-17.2%
Net profit margin	7.1%	16.6%	12.2%	15.5%	12.8%	14.0%	8.4ppt	-3.8ppt	1.9ppt	17.2%	-4.4ppt

Source: Company data, CMBIGM estimates

Figure 2: PE Chart



Source: Company data, CMBIGM

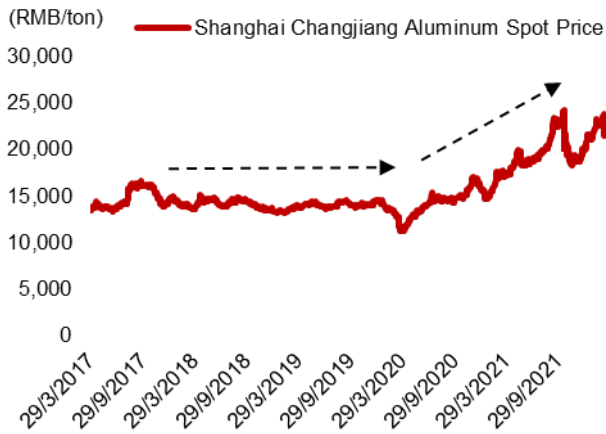
Figure 3: PE band – trading below 3yr av minus 1sd



Source: Company data, CMBIGM

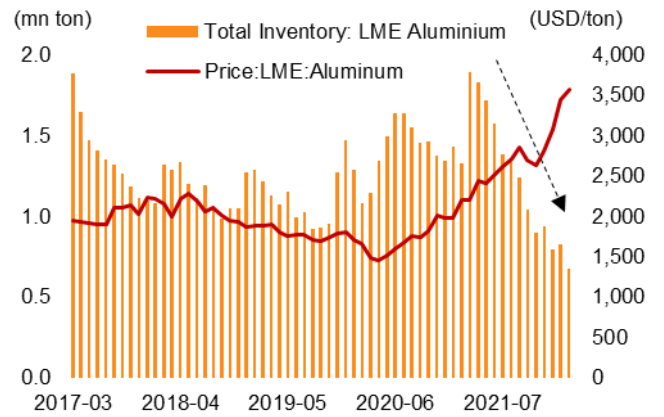
Focus chart

Figure 4: Spot price remained at higher level



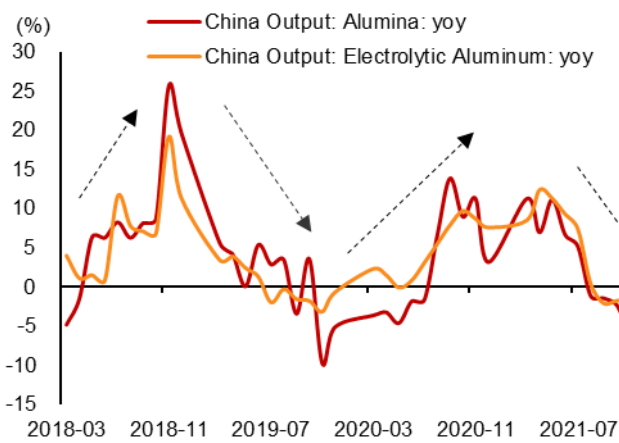
Source: Wind, CMBIGM

Figure 5: Global alum price hike with low inventory



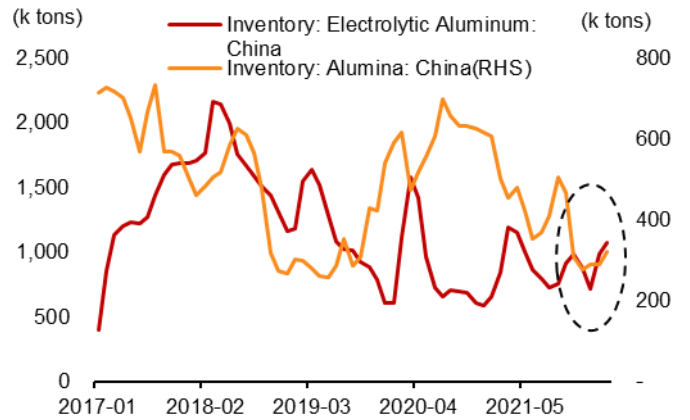
Source: Wind, CMBIGM

Figure 6: China output: supply-side reform continues



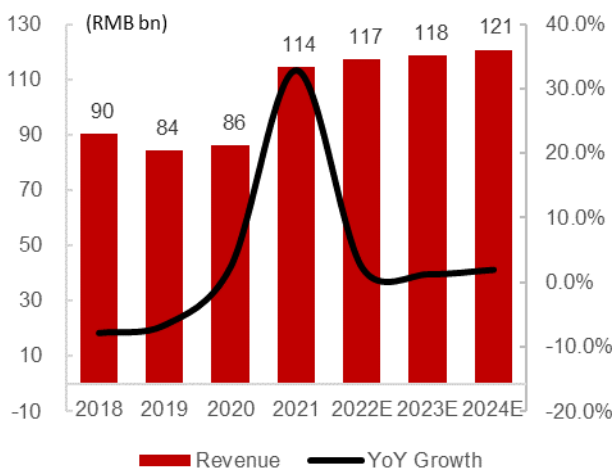
Source: Wind, CMBIGM

Figure 7: Expect re-inventory in 2022E



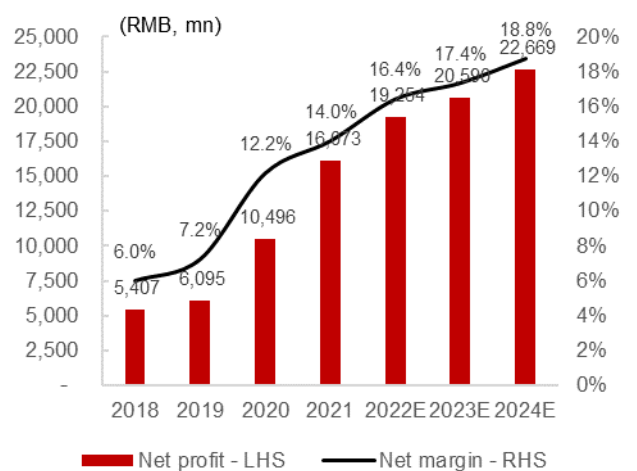
Source: Wind, CMBIGM

Figure 8: Revenue forecast



Source: Company data, CMBIGM estimates

Figure 9: Bottom-line forecast



Source: Company data, CMBIGM estimates

Figure 10: Our key assumptions and projections

	2020	2021	2022E	2023E	2024E
Aluminum product					
Production (k tonnes)	5,622	5,633	5,800	6,200	6,460
Sales (k tonnes)	5,060	5,020	5,207	5,756	6,187
Sales to production rate	90%	89%	90%	93%	96%
ASP (RMB/t, VAT excl.)	12,501	16,600	17,483	15,717	14,569
Revenue (RMB mn)	63,257	84,313	81,935	84,132	86,540
Aluminum fabrication					
Production (k tonnes)	622	672	739	813	877
Sales (k tonnes)	601	659	724	797	877
Sales to production rate	98%	98%	98%	98%	98%
ASP (RMB/t, VAT excl.)	14,877	19,090	20,106	18,075	17,337
Revenue (RMB mn)	8,781	12,524	14,862	14,697	15,507
Alumina					
Production (k tonnes)	14,650	14,650	15,400	15,650	15,650
Sales (k tonnes)	6,734	7,163	7,521	7,672	7,672
ASP (RMB/t, VAT excl.)	2,078	2,124	2,212	2,168	2,124
Revenue (RMB mn)	13,487	16,967	19,597	18,989	18,040
Internal consumption(k tonnes)	9,715	9,638	9,998	11,051	11,880
External procurement(k tonnes)	828	1,188	1,119	1,967	2,713
Self-sufficiency rate	90.0%	90.0%	90.0%	90.0%	90.0%
Material costs					
Coal costs(RMB/t VAT excl.)	509	664	708	664	575
Blended Bauxite costs (RMB/t VAT excl.)	353	396	385	360	359
Pre-cultured anode (RMB/t, VAT excl.)	2,676	3,163	3,340	2,986	2,986
Aluminum costs structure (RMB/tonne)					
Electricity costs	3,814	4,557	4,625	4,141	3,476
Alumina costs	3,372	3,583	3,601	3,446	3,418
Pre-cultured anode	1,285	1,518	1,603	1,433	1,433
Others	981	994	1,006	1,019	1,032

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	86,145	114,491	117,054	118,479	120,747
Aluminum products	63,257	84,313	81,935	84,132	86,540
Aluminum fabrication	8,781	12,524	14,862	14,697	15,507
Alumina	13,487	16,967	19,597	18,989	18,040
Steam	619	687	661	661	661
COGS	(66,789)	(84,038)	(84,943)	(85,164)	(85,179)
Gross profit	19,355	30,453	32,112	33,315	35,568
Other income and gains	2,701	3,707	3,548	3,608	3,762
S&D expenses	(400)	(526)	(537)	(544)	(554)
Admin expenses	(4,052)	(5,708)	(5,619)	(5,450)	(5,192)
Other expenses	(617)	(1,691)	(412)	(415)	(419)
Financial costs	(4,506)	(3,626)	(2,838)	(2,412)	(2,162)
Change in fair value	(291)	(117)	130	130	130
Share profits	515	62	639	666	684
Subsidy disposal loss	-	-	-	-	-
Profit Before Tax	12,704	22,554	27,023	28,898	31,816
Income tax	(2,260)	(5,705)	(6,756)	(7,225)	(7,954)
Less: Minority Interest	(51)	775	1,013	1,084	1,193
Net profit	10,496	16,073	19,254	20,590	22,669

Cash flow Summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Profit before tax	12,704	22,554	27,023	28,898	31,816
Interest payment	4,506	3,656	2,838	2,412	2,162
DD&A	7,565	7,743	7,954	8,192	8,431
Change in WC	(5,372)	(176)	(5,232)	1,643	(2,561)
Tax adjustments	(2,882)	(5,522)	(8,060)	(7,296)	(8,196)
Others	1,258	2,457	(2,107)	(3,026)	48
Net cash from operation	17,779	28,650	22,415	30,824	31,701
Capex & investments	(5,921)	(5,895)	(4,829)	(5,886)	(5,918)
Others	(1,053)	(425)	-	-	-
Net cash from investment	(6,974)	(5,102)	(4,829)	(5,886)	(5,918)
Equity raised	1,007	1,183	-	-	-
Change of Debts	(3,831)	(18,195)	(8,000)	(5,000)	(2,000)
Dividend paid	(3,833)	(7,145)	(7,786)	(9,527)	(10,188)
Interest payment	(4,506)	(3,656)	(2,838)	(2,412)	(2,162)
Others	4,014	5,526	1,013	1,084	1,193
Net cash from financing	(7,150)	(19,758)	(17,610)	(15,855)	(13,157)
Net change in cash	3,655	3,790	(23)	9,083	12,626
Cash at beginning	41,857	44,887	48,677	48,654	57,737
FX change	(625)	-	-	-	-
Cash at the end	45,465	49,227	48,654	57,737	70,363
Less: pledged cash	-	-	-	-	-
Cash at balance sheet	45,465	49,227	48,654	57,737	70,363

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current Assets	84,097	84,892	83,048	80,844	78,676
Fixed Assets	64,750	63,442	60,112	56,941	53,547
Right-of-use assets	5,647	5,718	5,750	5,950	6,150
Interests in associates	6,681	6,065	6,245	6,911	7,595
Others	7,019	9,667	10,941	11,041	11,384
Current Assets	97,434	103,528	108,947	119,786	133,827
Cash and cash	45,465	49,227	48,654	57,737	70,363
Trade and bills	19,493	19,203	22,826	23,103	23,546
Prepayments	9,126	10,768	12,876	11,848	11,471
Inventories	19,718	22,705	22,935	25,549	28,109
Others	3,631	1,624	1,657	1,549	339
Current Liabilities	73,351	61,158	56,268	41,204	40,338
Account Payables	13,377	18,735	16,989	17,033	17,036
Other payables	12,106	11,480	12,741	15,329	15,332
ST borrowings	45,577	26,120	21,686	3,961	3,059
Others	2,291	4,823	4,852	4,881	4,911
Non-Current Liabilities	30,163	31,284	30,809	42,362	41,426
LT borrowings	28,131	29,393	28,346	39,812	38,714
Derivative component of CB	550	241	253	266	279
Deferred income	582	835	877	921	967
Others	900	814	1,332	1,362	1,466
Total net assets	76,802	92,439	104,918	117,065	130,739
Minority Interests	5,606	11,131	12,144	13,228	14,421
Shareholder's equity	71,196	81,308	92,774	103,837	116,318

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
Aluminum products	73.4%	73.6%	70.0%	71.0%	71.7%
Aluminum fabrication	10.2%	10.9%	12.7%	12.4%	12.8%
Alumina	15.7%	14.8%	16.7%	16.0%	14.9%
Steam	0.7%	0.6%	0.6%	0.6%	0.5%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
P&L ratios (%)					
Gross profit margin	22.5	26.6	27.4	28.1	29.5
Operating margin	20.0	22.9	25.5	26.4	28.1
Net margin	12.2	14.0	16.4	17.4	18.8
Effective tax rate	17.8	25.3	25.0	25.0	25.0
Balance sheet ratios					
Current ratio (x)	1.33	1.64	1.92	2.87	3.31
Inventory turnover days	114.5	101.1	98.1	103.9	115.0
Creditor's turnover	86.7	61.7	65.5	70.7	70.5
Debtors turnover days	87.0	76.5	76.8	72.9	73.0
Liabilities/Assets (%)	57.7	50.9	45.5	42.0	38.5
Net gearing ratio (%)	39.7	7.7	NC	NC	NC
Returns (%)					
ROE	14.7	19.8	20.8	19.8	19.5
ROA	5.8	8.5	10.1	10.3	10.7
Per share					
EPS (RMB)	1.22	1.77	2.11	2.26	2.49
DPS (HK\$)	0.65	1.05	1.28	1.37	1.51
BVPS (RMB)	8.02	8.91	10.17	11.38	12.75

Source: Company data, CMBIGM estimates

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HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
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