



GNAM Investment Competition

HKUST MBA

Top Investment Idea–Angang Steel (000898.SZ)

30 Oct, 2016

Alex Lau

Fan Gao

Minyu Zhang

Yiwei Duan

Zongheng Xiao



Angang Steel –Key points

Strong steel price expected in China, with cost control advantages, make Angang highly attractive. Recommendation is a BUY given the following.

- **Downstream industries show growth potential and increasing demand for iron and steel**
- **The pattern of strong steel and weak iron ore prices drives the significant improvement of Angang steel**
- **Increase in steel prices index indicates rising output price of iron and steel**
- **The ability to merge and acquire other companies will improve the company's strength**

Rating	BUY
Target price	RMB 5.31
Current price	RMB4.56
Upside	16.44%

Stock Information	
Previous Close	4.56
Volume	18.7M
Day High/Low	4.55/4.61
52 wk High/Low	3.62/5.45
Market Cap	28.04B

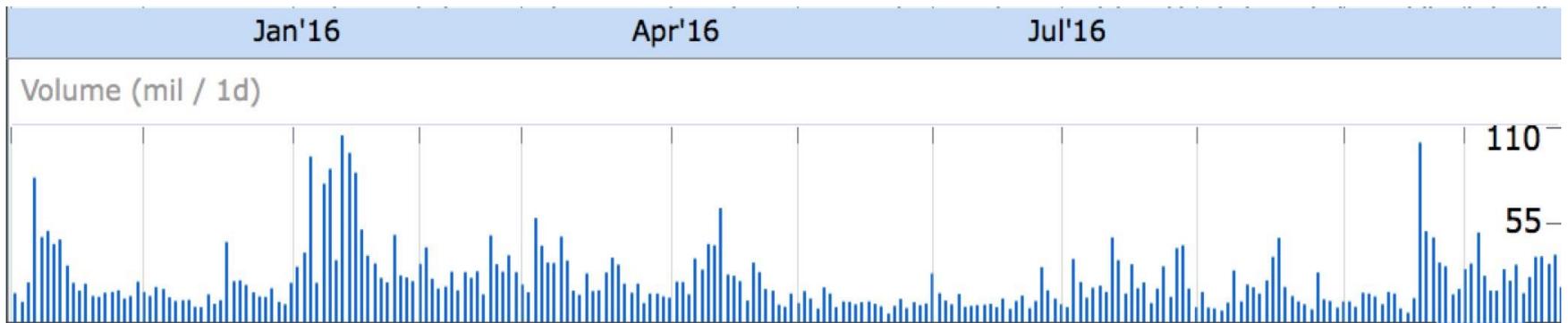


Angang Steel –Key points



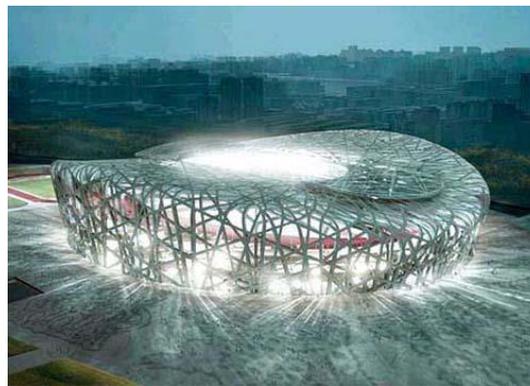
Suggest Buy

Analysts' Suggestion	Oct 2016
Buy	3
Outperform	13
Hold	1
Underperform	0
Sell	0



Who is Angang steel?

The company was formerly known as Angang New Steel Company Limited and changed its name to Angang Steel Company Limited in June 2006. The company was founded in 1997 and is headquartered in Anshan, the People's Republic of China. Angang Steel Company Limited is a subsidiary of Anshan Iron & Steel Group Complex. Angang Steel Company Limited engages in producing, processing, and selling of steel products in China. The company engages in ferrous metal smelting activities and produces various forms of steel sheets and plates, wire rods, heavy sections, and seamless steel pipes. In addition, it sells their products, domestically and internationally to various industries, such as light and heavy industries, and construction and infrastructure.



Competitor Analysis

- Because of the low steel price, all the steel companies' revenue fall down a lot in 2015. Benefiting from price recovery, the good companies, Banshan, Xinxing, Hesteel and Angang, rebound fast in the 9 months of 2016.
- Angang steel has a notable advantage on cost control and profitability. The Baoshan is the second follower, however, considering its acquisition of worse performer Wuhan Iron&steel, it will surpass by Angang steel quickly during market pick up.

Date	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
	Baoshan Iron&Steel (600019)				Wuhan Iron&Steel (600005)			
Revenue Increase (%)	9.2	-3.4	-14.8	-12.6	-16.4	-26.6	-41.3	-19.9
Operation Cost (%)	87.8	86.0	87.5	91.1	92.2	91.6	101.5	93.6
Profit Margin (%)	11.9	13.6	12.1	8.6	7.6	8.2	-1.9	6.1
Net Profit Increase (%)	151.0	9.9	-6.0	-88.3	-48.9	-93.0	-681.1	-224.6
	XINXING PIPES (000778)				Angang Steel (000898)			
Revenue Increase (%)	0.4	-14.8	-17.7	-22.3	-1.3	-12.3	-24.6	-28.7
Operation Cost (%)	94.6	95.0	95.4	96.5	86.5	87.4	93.0	93.8
Profit Margin (%)	5.3	4.8	4.4	3.4	13.0	12.1	6.5	5.8
Net Profit Increase (%)	-27.2	-22.2	-16.1	-65.0	230.3	86.7	-3516	-597.8
	Hesteel (000709)				Taigang Stainless Steel (000825)			
Revenue Increase (%)	-3.4	-10.7	-18.8	-25.6	-23.1	-29.1	-33.3	-21.7
Operation Cost (%)	87.2	87.8	89.5	86.7	85.3	85.1	90.5	95.3
Profit Margin (%)	12.6	12.1	10.5	13.1	14.3	14.4	9.1	4.5
Net Profit Increase (%)	118.7	23.1	-56.2	-44.0	N/A	829.4	-47596	-1478

Competitor Analysis

As a traditional industry, usually the P/B ratio is lower compared to other attractive industries. Because of the low steel price in the last year, together with the stock market crashing, the P/B ratio to all the steel companies are even less. It is safe time to buy in the shares of these companies. Because the market is picking up stably.

P/B Ratio



Valuation

- DCF Assumptions:
 1. A rapid growth rate of 18.7% in EPS for the first three years. Then decrease to 3% thereafter.
 2. Cost of Equity is 5.75%(Based on CAPM)
 3. Debt structure, capital spending and beta remains stable
- Model Used: FCFE Two Stage Model
- Estimated Price: 5.31(16.44% Upside)
- Estimation of Free Cashflow of Equity per Share

Estimated FCFE per Share					
	2015A	2016E	2017E	2018E	2019E
Earnings	-0.64	0.08	0.10	0.12	0.14
Earnings growth rate			18.70%	18.70%	18.70%
- (CapEx-Depreciation)*(1-DR)	0.00	-0.24	-0.29	-0.34	-0.41
-Chg. Working Capital*(1-DR)	0.00	0.00	0.00	0.00	0.00
Free Cashflow to Equity	-0.63	0.33	0.39	0.46	0.54

Valuation

FCFE Two Stage Method

Current Price							4.56
Estimated Price							5.31
Estimated Upside							16.44%
		Stablized Growth Rate					
		2.00%	2.50%	3.00%	3.50%	4.00%	
Cost of Equity	4.75%	4.36	4.82	5.45	6.34	7.69	
	5.25%	4.30	4.76	5.38	6.26	7.58	
	5.75%	4.24	4.70	5.31	6.17	7.48	
	6.25%	4.19	4.64	5.24	6.09	7.38	
	6.75%	4.14	4.58	5.17	6.01	7.28	
		2.00%	2.50%	3.00%	3.50%	4.00%	
	4.75%	-4.48%	5.80%	19.58%	39.03%	68.56%	
	5.25%	-5.72%	4.42%	18.00%	37.18%	66.29%	
	5.75%	-6.93%	3.06%	16.46%	35.36%	64.06%	
	6.25%	-8.12%	1.73%	14.94%	33.58%	61.87%	
	6.75%	-9.29%	0.42%	13.44%	31.82%	59.72%	

FCFE TWO STAGE METHOD

FCFE Two Stage Method-Value Per Share

Free Cashflow to Equity at Year 2019	0.54
Cost of Equity	5.75%
Growth Rate after Year 2019	3%
Terminal Value at Year 2019	4.82
Present Value of Terminal Price	4.08
Present Value of FCFE in high growth phase	1.23
Price of the Stock	5.31
Current Price	4.56
Estimated Upside	16.44%

Key points

Who is
Angang?

Competitor
Analysis

Valuation

Risk factors

Conclusion

Risks

- **Cost pressure from input, lower profitability**
 - Continued rising coal prices due to shortages at steel millers and Chinese government reforms on coal suppliers
 - Accelerated depreciation of Yuan increases costs of iron ore imports
- **Government strictly imposes steel supply cutback**
- **Slow down of steel consumers, lower sales**
 - Significant slow down in real estate construction, the largest consumer in steel
 - Significant slow down in infrastructure spending by the Chinese government

Conclusion

Industry prospects in the coming 6 months

- Rising steel price and weak input costs
- Strong downstream industries due to economy stabilization and policy changes

Competitive advantage of Angang

- Cost control advantage compared with other companies in the industry
- Merger and acquisition

Strong Buy

- Target price RMB5.31, 16.44% upside
- Risks to be mitigated by proactive management