

Analyst: Kelvin Li

Main Board H-share Listing – Research

中國冶金科工股份有限公司

Metallurgical Corporation of China Limited [Stock Code: 01618]

Sole Global Coordinator : Morgan Stanley
Joint Bookrunners, Joint Lead Managers and Joint Sponsors : Morgan Stanley Citi
CICC CITIC Securities International

Sector : Capital goods

Business : Metallurgical engineering and construction and other operations

<p>Total share offer: <u>2,871,000,000</u> H shares <i>(15.02% of the enlarged share capital, assuming the A-share offering is completed)</i> <i>(comprising 2.61 billion New H shares and 261 million Sale H shares)</i></p> <p>Public Offer: 143,550,000 H shares (5%)</p> <p>Placing: 2,727,450,000 H shares (95%)</p> <p>Greenshoe: 403,650,000 H shares</p>	<p><u>Business of Metallurgical Corp of China (MCC)</u></p> <p>MCC is an industrial group operating in various business areas. The Group's principal businesses included engineering & construction, resources development, equipment manufacturing, and property development.</p> <p>Engineering & construction is MCC's core business. The Group is the world's largest metallurgical engineering and construction contractor in terms of revenue of 2007. It provides steel and iron producers with one-stop services from survey, consulting, design, construction, technology upgrade to maintenance. Besides metallurgical projects, the Group is also engaged in building construction, transportation infrastructure, and construction projects in other industries.</p> <p>For resources development, the Group has mining interests in both the Mainland and overseas, mainly projects in metallic minerals. The equipment manufacturing segment involves the development and production of metallurgical equipment, steel structures and other metal products, to support its core metallurgical engineering and construction operation. The Group's property development is carried out under the brand "MCC Real Estate", with projects in various Mainland cities like Beijing, Shanghai, Tianjin, etc.</p>
<p>Price: HK\$6.16 – HK\$6.81 per share</p> <p>Market Cap: HK\$117.7 billion – HK\$130.1 billion <i>(assuming the A-share offering is completed)</i></p> <p>Pro forma fully diluted FY09E P/E: 26x – 28x</p> <p>Company guidance on FY09E net profit: not less than RMB4.06 billion</p> <p>Adjusted NTA per share: RMB1.52 – RMB1.67</p> <p>Staffing: 116,223 (as of 30th June 2009)</p>	
<p>HK Public Offer period: 11th Sep 2009 - 16th Sep 2009 noon</p> <p>Receiving bank: Bank of China (HK), Hang Seng Bank, Standard Chartered, HSBC</p> <p>Share registrar: Computershare Hong Kong Investor Services Ltd.</p> <p>Listing date: 24th September 2009</p>	

Shareholders after Listing (Assuming the over-allotment option is not exercised)

China Metallurgical Group Corporation – a state-owned company	64.18%
Baosteel Group Corporation	0.65%
National Council for Social Security Fund (NSSF)	1.83%
Public investors (A share)	18.32%
Public investors (H share)	15.02%
	<u>100.00%</u>

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$16.0 billion (based on an offer price of HK\$6.49, being the mid-point of the indicative price range and assuming the over-allotment option is not exercised)

	% of total
For the development of overseas engineering and construction operations, including funding overseas construction projects, purchase key metallurgical and mine construction equipment and advanced payment of construction costs.	45
To strengthen the Group's resources development capabilities and expand the resources development business scale.	33
For repayment of bank loans.	11
For general working capital.	11

Financial Highlights

	Year ended 31 st Dec			6 months ended 30 th Jun	
	2006	2007	2008	2008	2009
	RMB million	RMB million	RMB million	RMB million	RMB million
Total turnover	91,706	125,056	157,899	74,114	74,866
Gross profit	9,603	12,971	12,304	6,961	7,019
Operating profit	4,410	8,355	6,360	3,958	4,161
Profit/ (Loss) attributable to shareholders	1,920	3,855	3,200	2,056	2,137
Gross profit margin	10.5%	10.4%	7.8%	9.4%	9.4%
Operating profit margin	4.8%	6.7%	4.0%	5.3%	5.6%
Net profit margin	2.1%	3.1%	2.0%	2.8%	2.9%
	31/12/2006	31/12/2007	31/12/2008	30/06/2008	30/06/2009
Net debt (RMB million)	5,616	16,588	31,345	N/A	46,144
Net debt to Shareholders' Equity	N/A	638.5%	1,476.4%	N/A	1,884.2%

Breakdown of revenue in terms of business segments

	Year ended 31 st Dec						6 months ended 30 th Jun			
	2006		2007		2008		2008		2009	
	RMB million	%	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Engineering and construction	75,186	82%	97,856	78%	128,041	81%	59,894	81%	65,475	87%
Resources development	9,114	10%	13,338	11%	9,538	6%	5,406	7%	3,061	4%
Equipment manufacturing	5,374	6%	8,531	7%	15,649	10%	7,584	10%	4,375	6%
Property development	731	1%	3,888	3%	4,199	3%	1,057	1%	1,831	2%
Others	1,659	2%	2,317	2%	2,400	2%	1,123	2%	1,083	1%
Intersegment elimination	(358)	0%	(874)	(1%)	(1,928)	(1%)	(950)	(1%)	(959)	(1%)
Total	91,706	100%	125,056	100%	157,899	100%	74,114	100%	74,866	100%

Breakdown of operating profit in terms of business segment

	Year ended 31 st Dec						6 months ended 30 th Jun			
	2006		2007		2008		2008		2009	
	RMB million	%	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Engineering and construction	3,573	81%	6,426	77%	5,511	87%	3,159	80%	3,398	82%
Resources development	51	3%	674	8%	240	4%	424	11%	236	6%
Equipment manufacturing	716	16%	817	10%	562	9%	394	10%	267	6%
Property development	48	1%	471	6%	271	4%	78	2%	227	5%
Others	29	1%	80	1%	17	0%	10	0%	100	2%
Intersegment elimination	(107)	(2%)	(113)	(1%)	(241)	(4%)	(107)	(3%)	(67)	(2%)
Total	4,410	100%	8,355	100%	6,360	100%	3,958	100%	4,161	100%



Breakdown of backlog contract value of the Engineering and Construction segment

	As at 31 st Dec						As at 30 th Jun 2009	
	2006		2007		2008		2009	
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Metallurgical engineering & construction	53,696	65%	101,974	69%	114,577	67%	102,648	57%
Building construction	12,655	15%	18,425	12%	32,063	19%	40,616	23%
Transportation infrastructure	4,540	5%	6,582	4%	8,354	5%	11,763	7%
Other projects	12,033	15%	21,241	14%	15,067	9%	25,161	14%
Total	82,924	100%	148,222	100%	170,061	100%	180,188	100%

Breakdown of new contract value in terms of the Engineering and Construction segment

	Year ended 31 st Dec						6 months ended 30 th Jun 2009	
	2006		2007		2008		2009	
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Metallurgical engineering & construction	65,792	67%	134,873	74%	118,064	69%	35,145	44%
Building construction	12,130	12%	16,670	9%	29,976	17%	20,763	26%
Transportation infrastructure	5,259	5%	7,383	4%	8,298	5%	6,379	8%
Other projects	14,336	15%	22,972	13%	16,010	9%	17,449	22%
Total	97,517	100%	181,898	100%	172,348	100%	79,736	100%

Strengths/Opportunities

- ✓ MCC's gross profit margin narrowed to 7.8% in 2008 from 10.4% in 2007, due to sharply higher prices of steel, a key raw material in the Group's metallurgical construction operation, during Q1-Q3 2008. However, as steel prices started to retreat since Q4 2008, pressure on the Group's gross profit margin should lessen in 2009, and the management expects gross margin would revive to above 10% in FY09 (1H09: 9.4%).
- ✓ Major steel makers in the Mainland are seen to postpone or slow down their capital spending and capacity expansion in 2009 due to global financial tsunami. However, a total value of engineering and construction backlog contract of more than RMB180 billion as of the end of 1H09 should keep the Group busy in 2009 and maintain a solid business momentum this year.
- ✓ The Group saw solid new contract value growth in both building construction and transportation infrastructure projects in the first half of 2009, amid recovery in the Mainland property market and Beijing's RMB4 trillion stimulus package, which should help mitigate a possible slowdown in the new business momentum in its core metallurgical construction projects.
- ✓ As of 30th Jun 2009, the Group had 44 property projects under development or held for future development with a total site area of about 5.65 million square metres, which would fuel the future growth of MCC's property development.
- ✓ Five cornerstone investors (subject to a six-month lock-up period) will each invest HK\$387.6 million or a combined HK\$1.94 billion in the H-share offering. They included China Overseas Finance Ltd. (wholly owned by China Overseas Holdings Ltd.), CCB International Asset Management Ltd. (wholly owned by China Construction Bank (HKEx: 00939)), China Road Engineering and Investment Company Ltd. (wholly owned by China Communications Construction (HKEX: 01800)), Bank of China Group Investment Ltd. (a subsidiary of Bank of China (HKEX: 03988)) and CITIC Pacific Ltd. (HKEX: 00267). Each will hold an interest of about 0.31%, upon the completion of A-share and H-share offerings.

**Weaknesses/Threats**

- × The world' consumption and output of steel recorded the first negative growth since 2001 last year, amid financial tsunami hitting the global economy, down 0.3% and 1.2% from 2007, respectively. Dragged by recession in major economies overseas, steel output growth in the Mainland also tumbled to only 2.6% in 2008, compared with 15.7% in 2007 and 18.9% in 2008. Owing to a sharp fall in demand for metal products, major steel and iron products would postpone their capital spending and expansion plan, which may slow down the Group's business momentum in 2009-2010.
- × Abundant market liquidity helped support a strong rebound in both the Mainland and HK stock market since Q2 2009. However, any sharp market correction may hinder investors' appetite on IPOs.
- × In order to cope with overcapacity problem and enhance environmental standard in the iron/steel industry in the Mainland, Premier Wen announced that the Ministry of Industry and Information Technology (MIIT) will not grant any approval for construction of new steel plants in the next three years. It will drag on MCC's core metallurgical construction operations, which seems to crash with management's bullish business and profit guidance in the next couple of years.
- × Management lays out a valuation guidance of 26x-28x of estimated net profit for FY2009. Compared with valuations of other major HK-listed PRC infrastructure and construction plays, like CCCC (HKEx: 01800) at 16x FY2009E P/E, CRG (HKEx: 00390) at 22x and CRCC (HKEx: 01186) at 22x, MCC's valuation is not attractive given its less-favourable policy and sector outlook.

Recommendation: Trading Buy



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