



Share data

Price (10/4/2012)	HK\$2.16
12 mth target price	HK\$3.87
Code	1266
52 wk H/L	HK\$2.65/1.96
Issued shares	2,000mn
Mkt cap	HK\$4,320mn
Lot size	2,000
30-day avg. volume	9.5mn
Auditors	Ernst & Young
Major shareholder	
Mr. Wang Yong	75%

Source: Bloomberg, Xiwang

Corporate Details

Major products*: Ordinary steel (61.6%), special steel (37.5%), other (0.9%)

Major market: China (100%)

* Based on Xiwang's revenue composition for FY2011

Source: Xiwang

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Xiwang Special Steel Co. Ltd. (1266) - BUY

An integrated niche player in the special steel market

A niche player in the special steel market in Shandong Province, China – Shandong Provincial government is promoting its marine and heavy machinery industries in coming years. The rapid growing of these industries generates large demand for special steel products in the province. We expect Xiwang Special Steel (“Xiwang” or “the group”) to benefit from the expansion of its special steel production capacity and diversification of its special steel products.

Successful business strategies – The group posted an 84.5% growth in net profit to Rmb909.3mn for FY2011 and declares final dividend of Rmb0.137/share (ex-date May 21). The group succeeded in diversifying its products from low margin ordinary steel products to high margin special steel products and integrating its downstream rolling production line to upstream smelting production line last two financial years.

Sustainable growth momentum – The group raised net proceeds of HK\$991mn from the stock market in Feb to finance its capacity expansion plan in coming years. We believe its earnings growth momentum to sustain as it is expanding output of smelting lines and add new capacity on rolling lines to widen the scope of high margin special steel products in coming years. We forecast its revenue and net profit to grow by CAGR of 20.3% and 27.4% from FY11 to FY14, respectively. New product development risk is low as its new rolling line will commence commercial operation in the Q2 2012.

Less sensitive to property market cycle – Our analysis indicated most of ordinary steel producers are suffered from the slowdown of construction industry due to the cool down of the property market. The group succeeded in diversifying into special steel products which are used in various downstream industries. We believe the diversification of products helped to reduce overall business risk of the group in the long-term.

Negative outlook in the short-term – According to National Bureau of Statistics, total profit of ferrous metal mining and processing industry declined by 94% YoY for the first two months of 2012. The survey gives us an insight of the business condition of the ordinary steel industry in the Q1 2012.

Risks: Downside earnings risks caused by the decline in ASP of products or increase in costs of steel billets or steel scraps. Demand for products is adversely affected by availability of funding sources of customers.

Valuation

Based on the peer group comparison and DCF method, we value counter at HK\$3.87-4.95/share, which represents 6.00-7.68x of our est. FY12 FD EPS.

Financial Summary

FY ended Dec 31	2009	2010	2011	2012F	2013F	2014F
Net profit (Rmbmn)	194.1	492.8	909.3	1,046.7	1,293.8	1,879.7
Change (YoY)	346.5%	153.9%	84.5%	15.1%	23.6%	45.3%
FD EPS (Rmb/share)	0.121	0.308	0.568	0.523	0.647	0.940
Chg (YoY)	346.5%	153.9%	84.5%	-7.9%	23.6%	45.3%
FD PER (x)	-	-	3.09	3.35	2.71	1.87
NBV (Rmb/share)	0.219	0.530	1.183	1.742	2.625	3.764
P/B (x)	-	-	1.48	1.01	0.67	0.47
DPS (Rmb/share)	-	-	0.137	0.157	0.194	0.282
Yield	-	-	7.81%	8.95%	11.06%	16.07%

@Rmb0.8123/HK\$; EPS in FY09-11 and FY12-14 are based on 1.6bn and 2.0bn shares respectively.

Source: Xiwang (historical figures only), F: ABCI Securities estimates



農銀國際

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Xiwang Special Steel Co. Ltd.

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Financial Forecast Summary

FY ended Dec 31	Pre-listing				Post-listing		
	2008	2009	2010	2011	2012F	2013F	2014F
Sales volume ('000 tonnes)							
Special steel	-	-	115	710	1,231	1,430	1,993
Ordinary steel	984	1,229	1,358	1,238	1,151	1,061	989
Sales volume composition							
Special steel	0.0%	0.0%	7.8%	36.5%	51.7%	57.4%	66.8%
Ordinary steel	100.0%	100.0%	92.2%	63.5%	48.3%	42.6%	33.2%
Sales revenue composition							
Special steel	0.0%	0.0%	7.8%	37.5%	54.4%	61.3%	72.2%
Ordinary steel & others	100.0%	100.0%	92.2%	62.5%	45.6%	38.7%	27.8%
Revenue (Rmbmn)	3,858.3	3,776.9	5,387.3	8,541.0	9,937.4	11,087.0	14,871.0
Chg (YoY)	-	-2.1%	42.6%	58.5%	16.3%	11.6%	34.1%
Gross profit (Rmbmn)	125.6	246.5	601.0	1,293.0	1,524.2	1,807.8	2,553.7
Chg (YoY)	-	96.2%	143.8%	115.1%	17.9%	18.6%	41.3%
Net profit (Rmbmn)	43.5	194.1	492.8	909.3	1,046.7	1,293.8	1,879.7
Chg (YoY)	-	346.5%	153.9%	84.5%	15.1%	23.6%	45.3%
FD EPS (Rmb/share)	0.027	0.121	0.308	0.568	0.523	0.647	0.940
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FD PER (x)	-	-	-	3.09	3.35	2.71	1.87
NBV (Rmb/share)	0.049	0.219	0.530	1.183	1.742	2.625	3.764
P/B	-	-	-	1.48	1.01	0.67	0.47
DPS (Rmb/share)	-	-	-	0.137	0.157	0.194	0.282
Yield	-	-	-	7.81%	8.95%	11.06%	16.07%
Pro-forma issued shares (mn)	1,600.00	1,600.00	1,600.00	1,600.00	2,000.00	2,000.00	2,000.00
Gross profit margin	3.26%	6.53%	11.16%	15.14%	15.34%	16.31%	17.17%
GPM of special steel	-	-	6.52%	19.96%	18.97%	19.49%	19.29%
GPM of ordinary steel	2.84%	6.18%	11.24%	11.49%	10.03%	10.11%	10.05%
ROAA	-	7.9%	14.1%	20.5%	16.0%	16.3%	18.9%
ROAE	-	90.5%	82.2%	66.3%	38.9%	29.6%	29.4%
Total equity/total assets	14.7%	9.1%	27.0%	33.0%	47.6%	61.3%	66.3%

Stock closing price (10/4/2012): HK\$2.16

@Rmb0.8123/HK\$

ROAA=Net profit to the group/average total assets

ROAE = Net profit attributable to shareholders of the co./average equity attributable to shareholders of the co.

Remark: Xiwang completed the global offering of 400mn new shares at HK\$2.65/share and raised net proceeds of HK\$991mn in Feb 2012. Its shares have listed in the mainboard of the HK Exchanges from Feb 23, 2012.

Source: Xiwang, ABCI Securities estimates

Investment Themes

Outstanding financial performance

We compare the group with our identified comparable peers. The profitability of the group was outstanding.

	Gross profit margin in FY2011	ROAA FY2011	ROAE FY2011
Xiwang Special Steel (pre-listing)	15.1%	20.5%	66.3%
CITIC Pacific Special Steel#	-	5.3%	8.8%
Tiangong (826)	22.7%	7.7%	18.6%
Special steel players listed in A-share markets			
Xining Special Steel (600117)	19.5%	2.6%	12.0%
Daye Special Steel (000708)	8.3%	12.7%	21.5%
Fangda Special Steel (600507)	10.2%	8.3%	29.7%
Fushan Special Steel (600399)	7.5%	0.5%	1.9%
Zhongyuan Special Steel (002423)	15.1%	3.4%	5.0%

Note#: CITIC Pacific Special Steel is a business unit, which primarily engages in production and sales of special steel products, in CITIC Pacific (267).

ROAA = Net profit/average assets; ROAE = Net profit/average equity

Source: Annual results or reports of Xiwang, CITIC Pacific and Tiangong, Bloomberg, ABCI Securities estimates

We believe outstanding financial performance of Xiwang is due to the following reasons.

- Xiwang succeeded in integrated its smelting production line to lower the cost of production. Xiwang reduced proportion of low margin business (ordinary steel) and increased the proportion of high margin business (special steel). Hence, its gross profit margin was above average of comparable peer groups.
- Xiwang achieved very high production utilization rate in the period of our comparison, hence, it could be more selective in obtaining new orders. Thus, its ROAA was higher than average of its comparable groups.
- Xiwang was a privatized company prior to its listing exercise in Feb 2012. It had relatively low equity/assets ratio in 2011, whereas as its comparable peers are listed company with relatively high equity/assets ratio. Thus, its ROAE was higher than average of its comparable groups.

A niche player in special steel market in Shandong Province

The group is an integrated steel manufacturer in Shandong Province, the PRC with a focus on special steel production. The group has a niche in special steel market in this province. The strategic location of the group production facilities provides two major edges to the group – proximity to downstream customers and upstream raw materials suppliers.

In light of the Development Plan for the Shandong Peninsula Blue Economic Zone (or the “Plan”, Chinese name: 《山東半島藍色經濟區發展規劃》) enacted by the National Development and Reform Commission in January 2011, Shandong provincial government will put tremendous efforts to develop its marine industries including marine equipment manufacturing, marine resources & mining, and marine engineering. We expect the marine equipment & components manufacturing industry will become a key downstream



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industry for special steel product demand in the province. Furthermore, Shandong Province is one of the major heavy machinery production centers in China. Heavy machinery manufacturing industry has large demand for special steel products. Hence, we expect that the group's steel business will set to benefit from the development in the marine equipment & components manufacturing industry and the heavy machinery industry in Shandong Province.

Its production facilities are located in a geographic location in eastern China rich in crude steel and steel scrap, with developed processing and manufacturing industries and growing infrastructure constructions. Its proximity to suppliers lowers the transportation costs.

Product diversification leading to improvement of gross profit margin

The group succeeded to diversify its business from ordinary steel production with relatively low gross profit margin to special steel production with relatively high gross profit margin. Gross profit margin of the group's ordinary steel business improved slightly from 11.24% for FY10 to 11.49% for FY11. Meanwhile, gross profit margin of its special steel business improved significantly from 6.52% for FY10 to 19.96% for FY11. Proportion of sales of special steel products increased from 7.8% of total sales in FY10 to 37.5% of total sales in FY11. Meanwhile, proportion of sales of ordinary steel products reduced from 91.5% of total sales in FY10 to 61.6% of total sales in FY11. Overall gross profit margin of the group improved from 6.53% in FY09 to 11.16% in FY10 and 15.14% in FY11. We believe the group makes a right move in product diversification.

Successful upward integration leading to cost saving and reduce reliance on external supply of billets

The group has the largest designed Electronic arc furnace (EAF) based production capacity in Shandong Province. We analyze the EAF-based smelting production lines provide the following competitive edges to the group.

1. The group is able to produce a portion of steel billets for internal consumption in the downstream rolling business.
2. The group is able to produce special steel billets with specific composition required by customers such that the group is able to diversify its product range to high margin special steel products.
3. The EAF process is running at lower cost than conventional basic oxygen furnace (COF) process as the latter consumes iron ore, metallurgical coke and injected fuels. EAF uses electricity as primarily energy source. EAF process is able to use higher proportion of recycled steel scrap as raw materials. Since 2009, we estimate metallurgical coke price has increased by 80%. Meanwhile, government refrains from the large increase in electricity price to curb the inflation pressure last two years. EAF process has the cost advantages in terms of energy cost and raw material cost.
4. The flexibility of EAF process allows the group to change the product types with minimal operational downtime. This will increase the efficiency of the operation.



Running production lines at high utilization rates

The utilization rates of its smelting production lines and rolling production lines exceeded 100% in FY10 and FY11. The high utilization rates were the results of management efforts to improve the production process efficiency, expand annual working days and reduce operational downtime of the production lines. The overall utilization rates of smelting and rolling production lines were 113.6% and 113.4% in FY11, respectively.

To further expand the smelting production capacity, the group has employed engineer consultant Badische Stahl Engineering GmbH (“BSE”) to improve its production efficiency and enhance its capability to produce higher value-added products. We believe the improvement of production efficiency will subsequently return rate of assets.

Sustainable growth momentum

Its revenue and net profit to the group grew by CAGR of 30.3% and 175.5% from FY08 to FY11. The strong profit growth momentum was due to various factors, including the successful change of product mix which led to increase profit margins during the period, the expansion of output capacity which led to increase in sales volume and the operation of the first EAF line in FY10 which led to reduce the external purchase cost of steel billets. We believe the growth momentum of the group is sustainable in FY11-12 as the second EAF line has commenced operation in FY11 and a new large bar rolling production line is scheduled to commence operation in FY12. The total designed annual rolling production capacity will increase by 31% from 1.6mn tonnes to 2.1mn tonnes upon the operation of new large bar line. This new bar rolling line is for the production of gear special steel which we expect this product line to further enhance the overall profitability of the group.

Earnings outlook

We forecast the net profit to advance by 15.1% YoY to Rmb1,046.7mn for FY12. The net profit growth for FY12 will be backed by two major drivers.

1. Its annual designed rolling production capacity will grow by 31% upon the commencement of operation of its new large bar rolling line in this year.
2. The proportion of sales of high margin products (i.e. special steel products) will increase subsequent to the commencement of operation of new large bar line.

The new large bar rolling line has been in trial run for several months and will commence commercial production in the Q2 FY12. This new line is aimed to broaden the special steel product range. As the assets base increases, we estimate ROAA of the group to ease a bit to 16.0% in FY12 from 20.5% in FY11. As the group issued 400mn new shares at HK\$2.65/share in Feb 2012, its ROAE will dilute to 38.9% in FY12 from 66.3% in FY11.

Improving financial position

As the group was a private company with small capital base prior to its listing exercise in Feb 2012, it had high leverage ratio (measured by net bank loans/equity ratio). Its net debt/equity ratio was 78.7% at the end of 2011 (vs 102.4% at the end of 2010). The improvement of gearing ratio in 2011 was mainly due to the increase in retained earnings.

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In Feb 2012, the group raised net proceeds of HK\$991mn (or approx. Rmb804.7mn) by issuing 400mn new shares at HK\$2.65 each. The capital base of the group is strengthened subsequently. Moreover, the listing exercise of its shares in the HK stock exchange also diversifies the funding sources of the group from traditional bank loans to capital markets.

We estimate the pro-forma net debt/equity would have reduced to 25.4% at the end of 2011 if the new issues were completed at end of 2011.

For FY12, the group expects to incur a total capex of Rmb288.6mn to pay off the balance of construction cost of large bar rolling line and second EAF. The capex will further increase if the capex of its high-duty alloy pipe production line is included. Total capex of this alloy pipe production line is Rmb1.24bn, of which Rmb1.06bn and Rmb0.18bn will be spent in FY12 and FY13 respectively. In our cash flow forecast, we also factor in the capex of the alloy pipe production line into the total capex of the group for FY12 and FY13. We estimate the group is able to finance the completion of its large bar line by internal resources and bank borrowings. We estimate its net bank loans/equity ratio to decline from 78.7% at the end of FY11 and 6.6% at the end of FY12.

Valuation

We value the equity value of the group in two different approaches. We use comparison method to evaluate the group against the market valuation of comparable peers. We also use the discount cash flow method to value the equity value of the group. Combined these two methods, we appraise the equity in range of HK\$3.87-4.94/share, which represent FY2012 PER range of 6.00-7.68x. We set 12-month target price of the counter at HK\$3.87.

Valuation Summary

Valuation method	Appraised equity value HK\$/share	Corresponding FY2012 PER range
PER rating	3.87-4.83	6.00-7.50
Discount cash flow (WACC: 18.0-20.5%)	4.12-4.95	6.40-7.68

@Rmb0.8123/HK\$

Source: ABCI Securities estimates



Challenges in 2012

We identify several challenges that Xiwang has to come across this year.

- Poor business performance of steel industry in the Q1 2012
- Sluggish demand for ordinary steel in the Q1 2012
- Xiwang's prudent credit policy
- Rising scrap steel cost

Poor business performance of steel industry in the Q1 2012

We expect most of steel makers, especially ordinary steel makers, to post disappointed results for the Q1 2012. In the short-term, risk premium of steel industry should be high in view of unfavorable business environment of steel makers.

According to the survey conducted by National Bureau of Statistics of China (NBSC), total profit (operating profit + non-operating profit – operating expenses) of enterprises above designated size (i.e. annual revenue of principal business over Rmb20mn) in the ferrous metal mining and processing industry plunged by 94% YoY for the first two months of 2012. Total profit of this industry was up 53.0% YoY in 2011. The result of the survey indicated that the profitability of steel industry declined significantly in the first two months of 2012.

We believe the decline in profitability of the ferrous metal mining and processing industry in the first two months this year is due to sluggish demand in the downstream and weak product prices. According to NBSC, output volume of pig irons, crude steels and steel materials grew mildly by 3.2% YoY, 2.2% YoY and 4.6% YoY for the first two months of 2012 respectively.

Sluggish demand for ordinary steel in the Q1 2012

In view of the latest average spot prices of rebar and wire rod and import price of iron ore, the demand in the ordinary steel sector is still sluggish. Weak iron ore price suggests the utilization rate of smelting capacity in the ordinary steel industry remains low.

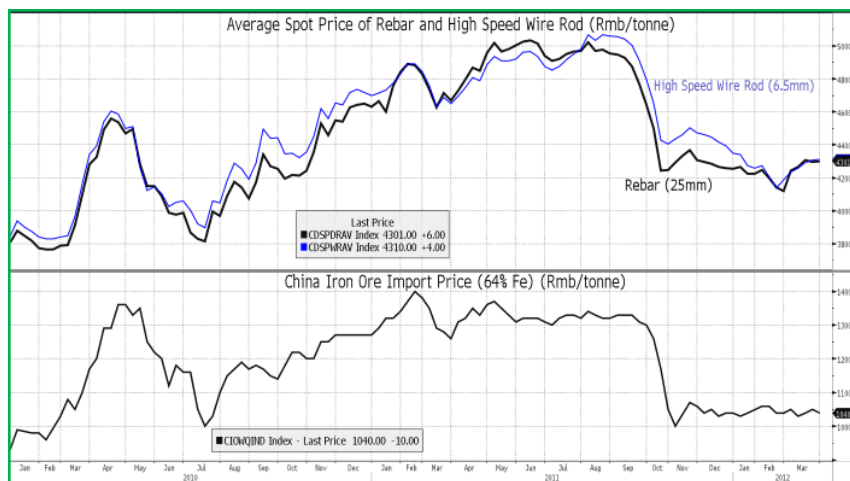
The decline of the profitability of the steel industry in the first two months this year also discouraged players in the industry to invest into the fixed assets. The fixed assets investment in smelting and pressing of ferrous metals manufacturing industry grew mildly by 3.2% YoY to Rmb29,951mn for the first two months of 2012. Steel players constraint their future capacity expansion.

However, fixed assets investment in general purpose machinery, special purpose machinery and automobiles industries grew by 45.4% YoY, 58.8% YoY and 46.2% YoY for the first two months this year, according to "Investment in Fixed Assets (Excluding Rural Households) by Industry" monthly survey conducted by National Bureau of Statistics. These three industries are major users of special steel. The strong growth of fixed assets investment in these three industries will boost the future demand for special steel.



Upper chart: Average spot price of rebar and high speed wire rod (Rmb/tonne)

Lower chart: China iron ore import price (64%Fe) (Rmb/tonne)



Remark: Rebar size 25 mm; Wire rod size 6.5 mm

Remark: Iron ore import price at Qingdao Port

Source: Bloomberg

Challenge on credit policy

Xiwang demands its customers to prepay before delivery of goods. This practice is good to reduce credit risk of Xiwang. However, the demand for Xiwang's products will be affected by the availability of the funding sources of the customers. Trade receivables turnover days of the group rose from 0.48 day in FY10 to 0.96 day in FY11. Meanwhile, bills receivables turnover days sharply increased from 2.26 days in FY10 to 11.96 days in FY11. The sharp increase in bills receivables turnover days indicated that customers lacked cash to settle the transactions before they took delivery of goods on one hand and Xiwang relaxed its credit policy to customers on the other hand.

Possible sharp increase in scrap steel cost

Scrap steel is one of major raw materials of the group's EAF-based smelting production lines. According to China Economic Information Network, the average import scrap steel price in China is in rising trend. The trend is unfavourable to Xiwang. The average import scrap steel price rose from US\$513.55/tonne in 2010 to US\$610.87/tonne, up 18.95% YoY. Average import scrap steel price climbed up further to US\$639.62/tonne for the first two months of 2012, up 18.52% YoY.

Average scrap steel purchased by the group was Rmb2,179/tonne (or US\$324.40/tonne @Rmb6.717/US\$) and Rmb2,353/tonne (or US\$364.58/tonne @Rmb6.454/US\$) for FY10 and FY11 respectively. The average purchase price of scrap steel by the group was 36-40% lower than the average import price last two financial year. We estimate the group consumed approx. 760,297 tonnes of scrap steel at total cost of Rmb1,789.0mn for FY11. If the scrap steel cost were at US\$610.87/tonne (i.e. average import price of scrap steel in 2011), Xiwang's scrap steel cost would have increased to Rmb2,997.5mn, up Rmb1,208.5mn, for FY11. The additional scrap steel cost would have almost totally eroded its total gross profit of Rmb1,293.0mn for FY11. The scenario analysis indicates the group's profitability in the future is very sensitive to the change of the purchase price of scrap steel.

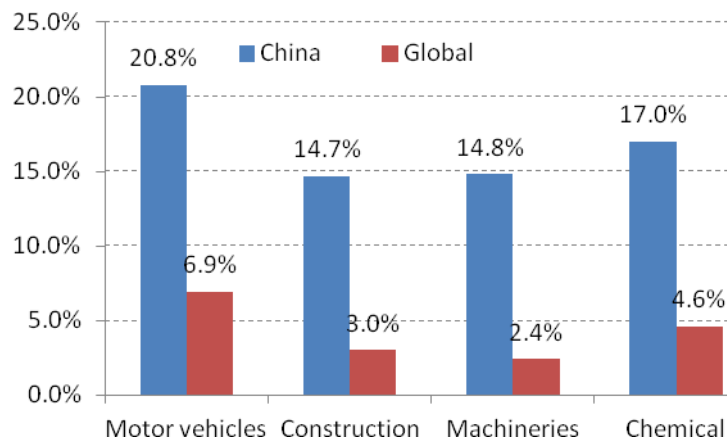


Industry Outlook

Downstream demand growth will slow down but remain high compared with the rest of the world

Major uses of steel are construction, motor vehicles and mechanical engineering. Historically, the downstream industries of the steel market in China posted stronger growth than the rest of the world. According to CRU Strategies Limited (“CRU”), a specialized London-based market research provider, the construction industry posted a CAGR growth of 14.7% in China compared to 3.0% in the rest of the world during 2005 to 2009; motor vehicles posted a CAGR growth of 20.8% in China compared to 6.9% in the rest of the world during 2003 to 2010; and machineries posted a CAGR growth of 14.8% in China compared to 2.4% in the rest of the world during 2006-2010.

Historical Industries CAGR Growth



Source: CRU; Datamonitor

*Motor vehicles industry CAGR growth is based on data in 2003-2010

* Global construction data only include data from US and EU area

* Machineries industry CAGR growth is based on data in 2006-2010

* Chemical industry CAGR growth is based on data in 2005-2009

Although CAGR growth rate of the downstream industries are going to slow down, we believe these industries in China will continue to outperform the rest of the world in terms of growth rate. According to CRU, construction, motor vehicles and machineries industries will post an average growth rate of 7.0%, 11.5% and 8.5% respectively during 2010 to 2015. The continual strong growth of the downstream industries will create demand for the steel players.

Downstream industries growth in 2010-2015

	China 2010 – 2015 CAGR growth
Motor vehicles	11.5%
Construction	7.0%
Machineries	8.3%
Chemical	13.3%

Source: CRU; Global Insights



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The group’s products are classified into ordinary steel and special steel. The demand of end-users for these two types of products is different.

Outlook of the ordinary steel market in China

Rebars and wire-rods, two major ordinary steel product groups, are consumed mainly by construction industry. We believe the construction industry in China is sensitive to the fixed assets formation growth of the overall economy.

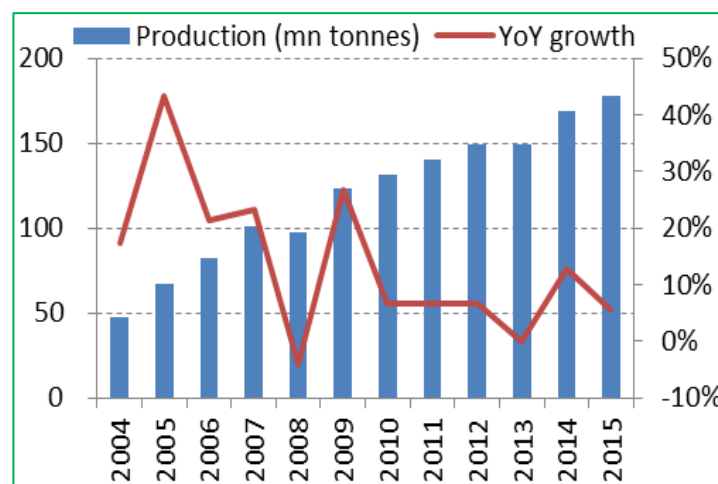
We expect the growth of production volume of rebars and wire-rods to slow down in coming years due to the following reasons.

1. Comparison base is high in previous years after strong output growth during 2009-2010
2. Steel makers constrain the output growth as the construction industry is affected by the government-induced policy to curb the speculation activities in the private property market.
3. The slowdown of construction activities in the private property sector is cushioned off by the government-induced policy to encourage the construction of the housing in the public sector.
4. Government policy encourages to eliminate outdated inefficient steel production capacity.

According to the market survey conducted by CRU Strategies Limited (“CRU”), a specialized London-based market research provider, production volume of rebars and wire rods in China grew by CAGR of 18.5% and 14.5% in volume from 2003 to 2010 respectively. CRU estimated that production volume of rebars and wire rods reached 131.2mn tonnes and 105.1mn tonnes in 2010 respectively.

CRU forecasts to production volume of rebars to grow by CAGR of 6.3% from 140.0mn tonnes in 2011 to 178.1mn tonnes in 2015. Meanwhile, CRU forecasts production volume of wire rods to grow by CAGR of 5.7% from 111.8mn tonnes in 2011 to 138.9mn tonnes in 2015.

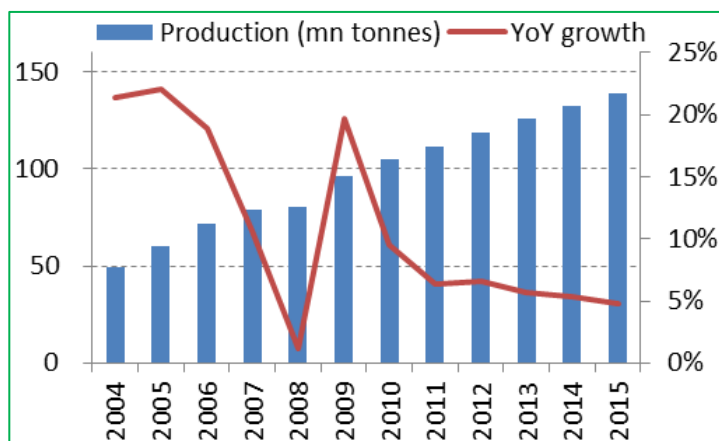
Rebars production in China



Source: CRU



Wire rods production in China



Remark: "YoY growth" means year-on-year growth rate

Source: CRU

Production volume in China

Types of ordinary steel	Historical 2003-10 CAGR	Forecast 2011-15 CAGR	Change
Rebars	18.5%	6.3%	-12.3ppt
Wire rods	14.5%	5.7%	-8.8ppt

Source: CRU

Outlook of special steel market in China

As we expect the construction industry, which consumes mainly ordinary steel, to grow more slowly than the machinery and auto industries, which consume mainly special steel, we expect to see stronger growth in special steel products compared to ordinary steel products.

Based on figures provided by CRU and Mysteel.com, alloy steel production in China in 2010 is estimated to achieve a CAGR growth of 9.5% during 2010 and 2015, compared with 6.3% and 7.5% CAGR growth for rebars and wire rods.

Policies favor special steel production

Two of the major objectives for the steel industry for the period 2011-2015 in the twelfth Five Year Plan are

- 1) Eliminate outdated capacities;
- 2) Accelerate technology and industry upgrades to foster a sustainable economy.

In our view, elimination of capacities will remove excess steel production capacity, especially for ordinary steel, which is experiencing a decelerating market. On the other hand, the PRC government issued a policy document in Oct 2010, expressing support for the development of new engineering materials of various types, specifically including high-quality special steel.

In terms of accelerating technology and industry upgrades, the PRC government encourages to increase the recovery rates of steel scrap and greater use of electric arc furnace-based steelmaking on environmental



grounds. The policies benefit special steel producers which employ electric arc furnace in production such as the group.

Outlook of special steel industry in Shandong Province

The group has commenced production of special steel in 2010 with sales volume of 114.7K tonnes in 2010 and 710.2K tonnes in 2011, respectively. The main target market of the group's special steel products is in Shandong Province where its production facilities locate. Hence, the demand for special steel in Shandong Province is a crucial factor to affect the group's business performance in the short to medium term.

Demand for special steel in Shandong Province is mainly derived from two major industries.

1. Marine equipment & components manufacturing industry
2. Heavy machinery industry

In light of the Development Plan for the Shandong Peninsula Blue Economic Zone (or the "Plan", Chinese name: 《山東半島藍色經濟區發展規劃》) enacted by the National Development and Reform Commission in January 2011, the Plan explicitly pointed out that Shandong Province should put in great efforts in developing its marine industries including marine equipment manufacturing, marine resources & mining, and marine engineering. The marine equipment & components manufacturing industry becomes a key downstream industry for special steel product demand. In the marine equipment & components manufacturing industry, key parts (such as electric gear and gear rack of spud legs and lifting systems) of marine platforms (such as oil platforms and drilling platforms) require special steel products.

Shandong Province is one of major heavy machinery production centers in China. According to data from the Shandong Province Machinery Industry Association in 2010, the sales revenue, gross industrial output, and taxes of Shandong machinery industry all ranked second in PRC. Production capacity and market shares of products such as heavy duty automobile, light truck, and large-scale forging equipment all ranked first in PRC. Heavy machinery manufacturing industry has large demand for special steel products. In the heavy machinery manufacturing industry, most steel products used in spare and accessory parts (such as bearing, axle shaft, high-strength spring, large gear and flange) are special steel products including carbon structural steel and alloy steel.

Hence, we believe the development in the marine equipment & components manufacturing industry and the heavy machinery industry in Shandong Province will stimulate the market demand for special steel in this region and will benefit special producers such as the group located in the province.



Competitive Landscape

The group has two major types of products – ordinary steel and special steel. Its rolling capacity is 1.6mn tonnes and will increase to 2.1mn tonnes upon the commencement of commercial production of a new production line in 2012. Hence, the group is competing with ordinary steel producers in the ordinary steel segment and with special steel producers in the special steel segment.

When we analyze the competitive landscape of the group, we need to consider the competitive landscape of these two product segments.

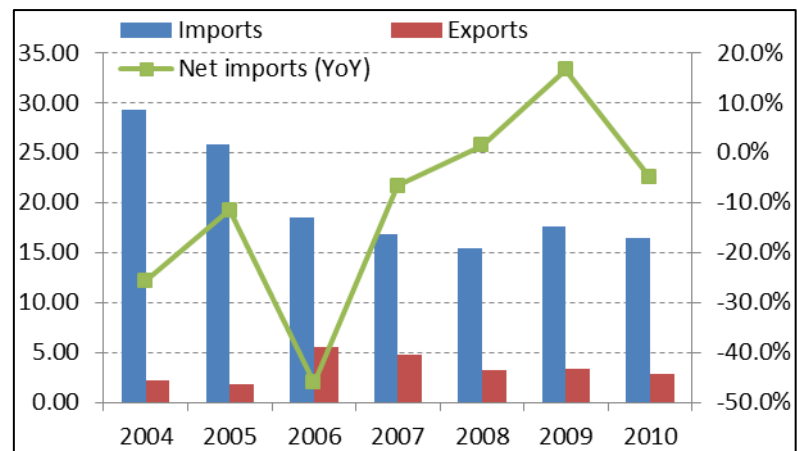
The Chinese steel industry is considered fragmented. According to China Steel Year Book 2010, the five and ten largest steel producers in China accounted for 29.0% and 43.9% of the total steel production volume in 2009, respectively. Given that the government has the aim to eliminate inefficient and excess capacity in China, industry consolidation is inevitable. We expect the concentration of the steel industry will increase in coming years.

China’s major crude steel producers

2009	Volume (mn tonnes)	% of total
1 Hebei Iron & Steel Group	40.2	7.1%
2 Baosteel Group	38.9	6.9%
3 Wuhan Iron & Steel Group	30.3	5.3%
4 Angang – Bengang Group	29.2	5.1%
5 Jiangsu Shagang Group	26.4	4.6%
6 Shandong Iron & Steel Group	21.3	3.8%
7 Shougang Group	19.5	3.4%
8 Hebei New Wu’an Iron & Steel Group	16.7	2.9%
9 Magang Group	14.8	2.6%
10 Hunan Hualing Iron & Steel Group	11.9	2.1%
Sub-total of top 10	249.2	43.9%
Others	318.6	56.1%
Total	567.8	100.0%

Source: China Steel Year Book 2010

China steel products trade



Source: General Administration of Customs of the PRC

According to the statistics released by General Administration of Customs of



Xiwang Special Steel Co. Ltd.

the PRC, China was a net importer of steel products from 2004 to 2010. Domestic producers of steel products not only have to face competition from other domestic producers but also have to compete with foreign players. China imported 17.6mn and 16.4mn tonnes of steel products in 2009 and 2010 respectively but imports growth was in a declining trend while net imports posted negative growth annually during 2004 to 2010 except in year 2008 and 2009.

Due to overcapacity in ordinary steel, the PRC government encourages industry consolidation and at the same time encourages the production of high-value added steel products such as special steel.

The 26 special steel producers CRU identifies scattered across 13 provinces of China, for which Shandong Province has the greatest share of production. The three largest steel producers in Shandong Province in terms of a combined production volume of special and ordinary steel are Shandong Steel Group (Chinese name: 山東鋼鐵集團股份有限公司), Rizhao Iron & Steel Shareholding Co., Ltd. (Chinese name: 日照鋼鐵集團有限公司) (“Rizhao Iron & Steel”) and Qingdao Iron & Steel Co., Ltd. (Chinese name: 青島鋼鐵控股集團) (“Qingdao Iron & Steel”). According to China Steel Yearbook 2010, the three producers mentioned respectively accounted for 35.8%, 16.3% and 5.5% of the market share in Shandong Province in 2009. These three producers captured 57.6% of the market share in Shandong Province. We see special steel market in Shandong Province has high market concentration.

The group has begun to sell special steel since June 2010. Hence, the market statistics of the special steel industry prior to 2010 does not include the group’s special steel products. However, we believe the group is competing in a highly concentrated special steel industry in Shandong Province.



Business Strategies

The group is to maintain its position as one of the leading steel producers with integrated EAF-based production facilities and to meet the increasing demand for special steel products while maintaining and enhancing its profit margins. The group formulates the following business strategies.

- Improve product mix by increasing production and sales of high value-added special steel products
- Increase direct sales to end users
- Expand into markets outside Shandong
- Improve quality of personnel

Improve product mix by increasing production and sales of high value-added special steel products

The group will add a new rolling line which focus on production of gear special steel product in FY12, bringing total effective production capacity of its rolling production lines from 1.6mn tonnes per annum to 2.1mn tonnes per annum. Moreover, the group plans to continue to increase the production of high value-added special steel products and expand into downstream production. One of the major products will be the construction of high-duty alloy pipes production line. The new production line is expected to expand the variety and improve the quality of products. With planned production capacity of 500,000 per year and current price of approximately Rmb6,700/tonne for similar products, the business strategy is expected to raise the group's profit margin in the long-term.

Increase direct sales to end users

The group plans to increase its direct sales to end user customers primarily in connection with increasing sales of special steel products. The goal will be achieved by 1) frequently attending various national and provincial special steel industry events in order to showcase the group products and technologies to a large number of potential end user customers; 2) increase visits to existing and potential customers; 3) offer competitive prices to customers while maintaining quality of products.

Expand into markets outside Shandong

Taking advantage of the group's leading position in Shandong, the group plans to increase its presence in nearby provinces through increase in sales and marketing force and further improvements to the post-sales services in the major provinces of eastern China.

Improve quality of personnel

Human resources are essential to R&D and operation efficiency, which is the key to achieve leadership position. To strengthen the group's leading position, the group plans to increase training. The group intends to send an additional of 28 engineers and technicians to BSE's German production facilities for technical training. Experts will also be invited from BSE to provide onsite training. In addition, the group will continue to actively recruit specialists in special steel industry by offering competitive compensation and benefits and providing a supportive work and research environment.



Analysis of Business Strategies

We see the business strategies have the following advantages to the group in the medium to long-term.

Reduction of business risk – The group is diversifying its products from ordinary steel to special steel, and broadening the range of special steel products. Ordinary steel such as rebars and wire rods are mainly used in the construction industry which is sensitive to the business cycle of the property market. The group reduces the reliance of the sales of ordinary steel products and its sales will become less vulnerable to the cycle of the property market. Moreover, special steel are widely used in various industries such as automobile, heavy machineries, marine equipment, petrochemical, etc. Those industries have different business cycles and subject to different macro-economic conditions. We believe the group, by broadening the range of special products, will subsequently diversify the systematic risk and lower the overall business risk of the group in the medium to long-term.

Understand the demand of end-users – To capture the demand for special steel in various industries, the group needs to understand the specific need of the customers. Unlike ordinary steel which usually has standard specification and is hard to have product differentiation, special steel end users demand for specific composition in the special steel in a bid to fulfill their specific needs. Hence, special steel producers such as the group are able to tailor made products to special steel end users. Hence, it is crucial for the group have direct sales relationship with end users in order to provide tailor made special steel products.

Improvement of profit margin – The historical results of the group indicated that gross profit margin of special steel is higher than ordinary steel in percentage term or in unit gross profit term. Gross profit margin of ordinary steel was 11.24% for FY10 and 11.49% for FY11. Meanwhile, gross profit margin of special steel improved from 6.52% for FY10 to 19.96% for FY11. The group should deploy more resources to high profit margin business in order to optimize the return of the invested capital.

Optimize the production capacity – The group was running its EAF-based smelting production lines at overall utilization rate of 117.2% in FY10 and 113.6% for FY11. Its rolling production lines were operated at overall utilization rate of 103.4% in FY10 and 113.4% for FY11. To group plans to increase the effective production capacity of existing EAF-based smelting lines and rolling lines. The group employs Badische Stahl Engineering GmbH (“BSE”), which based in Kehl, Germany and is an engineering and consulting group that supplies technical equipment and engineering services to steel and rolling mills across the world, to increase effective production capacity of existing production lines. As the lines are running at high utilization rate, it is important to have competent personnel to maintain the efficiency.



Product Analysis

The group has two main product lines – ordinary steel and special steel. Product types of its ordinary steel include rebars and wire rods, which are mainly used in construction and infrastructure projects. Product types of its special steel include quality carbon structural steel, alloy structural steel, bearing steel and steel welding wire, which are used in a wide variety of applications, including production of seamless steel pipes, bearings, gearings, machines parts and steel welding wires.

The group is installing a third bar rolling line to manufacture large bar special steel products, including bearing steel bars and gear steel bars, which are widely used in the manufacturing of machinery, equipment and automobiles. The group also plans to build a high-duty alloy pipes production line in 2012-13 which is expected to commence production in Oct 2013.

In view of its business strategies and its expansion plan of its production lines, we believe proportion of revenue of special steel products will increase and proportion of revenue from ordinary steel products will decline.

Our analysis indicated most of ordinary steel producers are suffered from the slowdown of construction industry due to the cooling down of the property market. We believe the group has broadened its products range from ordinary steel to special steel which are subsequently used in various industries such as machineries, automobiles, marine, chemicals and petrochemical. We believe the diversification of products will reduce overall business risk of the group in the long-term.

Major Products of Xiwang

Product names	Definition
Special steel:	
Existing products	
1 Alloy structural steel	It is alloy steel used in structures. Alloy steel is defined as any steel, excepting stainless, containing a minimum of any of the following alloying metals: 0.3% aluminum; 0.0008% boron; 0.3% chromium; 0.3% cobalt; 0.4% copper; 0.4% lead; 1.65% manganese; 0.08% molybdenum; 0.3% nickel; 0.06% niobium; 0.6% silicon; 0.05% titanium; 0.3% tungsten; 0.1% vanadium; 0.05% zirconium; or 0.1% of any other single element apart from carbon, oxygen, sulphur and oxygen.
2 Quality carbon structural steel	Steel where the main alloying constituent is carbon
3 Bearing steel	It is steel products designed to have mechanical properties suited for lowering friction levels in continuously moving machine parts. The main use of bearing steel products is in ball, roller, tapered and needle bearings. Bearing steels contain 0.5 to 2.0% chromium and 0.55 to 1.10% carbon. Manganese content is in the range of 0.10 to 1.15% and silicon content in the range of 0.15 to 2.0%. Typical bearing steel for small bearings might contain 1.00% carbon and 1.50% chromium, together with 0.25% silicon and 0.35% manganese. For larger bearings, the silicon and manganese content may be increased. For especially large bearings, the chromium content may be increased and molybdenum may be added.
4 Steel welding wire	Steel wire products typically used in the welding electrode wires in the electrode conduit and liner of welding guns and welding torches.



New products to be developed

- | | | |
|---|-----------------------|--|
| 5 | Gear steel | Steel products typically used in vehicle gear manufacturing. The group does not have this product now and plans to commence production in May 2012. |
| 6 | High-duty alloy pipes | Special steel pipes with high corrosion and heat resistance are used in boiler pipes, corrosion-, pressure- and temperature-resistant oil well drill pipes and high corrosion-resistant chemical pipes. The group does not have this product now and plans to commence production in Oct 2013. |

Ordinary steel:

- | | | |
|---|----------|--|
| 1 | Rebar | Ordinary steel bar with cross-sectional diameters ranging from 12 to 32 mm which is commonly used as a tensioning device in reinforced concrete and reinforced masonry structures holding the concrete in compression. |
| 2 | Wire rod | The smallest sections of ordinary steel that can be produced by hot rolling, produced in irregular coils, typically with cross-sectional diameters ranging from 5.5 to 12 mm. |

Source: Xiwang



Production Capacity

Capacity constraint is our primary concern when we analyze the growth momentum of the group.

To avoid doubt, we mention “designed capacity” which represents the full annual capacity designed by the provider of the manufacturing facilities. It is based on the assumption that the line commenced full calendar year production without any interruption. We mention “effective capacity” which is calculated based on the designed annual capacity divided by 12 and multiplied by the number of months that such production line had been in normal operation during the year. Normal operation refers to a status of operation that excludes either: (i) the monthly production is less than 5% of the designed capacity of the line during trial production, or (ii) such production line is under the process of technical upgrading with monthly production mostly less than 5% of its designed capacity. We mention “utilization rate” which refers to the ratio of annual production volume to effective production capacity.

The group has two EAF-based smelting production lines with total designed capacity of 1.0mn tonnes per annum. These two lines were running at utilization rate exceeding 100% in FY10 and FY11. The group increased the output by increasing smelting capacity per batch, reducing smelting time and expanding annual working days. Hence, the annual production exceeded designed capacity.

The group has three rolling production lines – one for production of wire rod and two lines for bar production. The group has installed a third large bar production line and is in trial run. The large bar production line is schedule to commence commercial production in FY12. The existing rolling lines were also running at utilization rate exceeding 100% in FY10 and FY11. To achieve high utilization rate, the group increased annual working day periods and production efficiency, and reduced operational downtime of the lines.

Unless the group plans to add smelting production lines in the foreseeable future, the total effective production capacity of these two EAF-based smelting lines will become bottle neck of the group. In particular, we expect these two lines will mainly produce special steel billets for downstream rolling lines to produce special steel products. To expand the designed capacity of these two lines, the group has employed engineer consultant Badische Stahl Engineering GmbH (“BSE”) to upgrade the production lines.

Downstream rolling production capacities exceed upstream smelting production capacity. We estimate total annual designed smelting production capacity was 31.3% and 62.5% of total annual designed rolling capacity for FY10 and FY11, respectively. We believe the group will use most of the smelting capacity to produce special steel billets to satisfy internal consumption as special steel products enjoyed higher gross profit margin than ordinary products.

In particular, the group will commence commercial production of a large bar production line which aims to produce gear special steel product. Internal demand for special steel billets in the downstream production line will increase accordingly this year. If the group is able to expand special steel billets production in its smelting lines, the profitability will be enhanced. Hence, the business performance of the group’s special steel product line in the future is sensitive to how large extent the smelting capacity can expand.



Production Line Capacities and Utilization

Smelting and casting production line (EAF I & II)

FY ('000 tonnes)	2008	2009	2010	2011	2012F	2013F	2014F
Smelting (EAF I & II)							
Designed capacity	-	500	500	1,000	1,200	1,500	1,800
Effective capacity	-	125	500	958	1,200	1,500	1,800
Annual production	-	68	586	1,088	1,320	1,500	1,800
Utilization rate	-	54.0%	117.2%	113.6%	110.0%	100.0%	100.0%

Remark: Steel smelting is the production process of molten steel. Steel casting is a process whereby molten steel is cast into billets using a continuous casting machine, which improves the yield rate by eliminating the wastage inherent in the latter process.

F: ABCI Securities estimates; Source: Xiwang (for historical figures only), ABCI Securities estimates

Rolling production line (Wire, Bar I, II & III)

FY ('000 tonnes)	2008	2009	2010	2011	2012F	2013F	2014F
Rolling (Wire, Bar I, II & III)							
Designed capacity	1,000	1,600	1,600	1,600	2,100	2,100	2,100
Effective capacity	1,000	1,217	1,332	1,600	2,100	2,100	2,100
Annual production	984	1,216	1,378	1,815	2,317	2,500	2,500
Utilization rate	98.4%	100.0%	103.4%	113.4%	110.3%	119.0%	119.0%

Remark: Rolling is a continuous bending operation in which a long strip of metal (typically coiled steel) is passed through consecutive sets of rolls, or stands, each performing only an incremental part of the bend, until the desired cross-section profile is obtained.

F: ABCI Securities estimates; Source: Xiwang (for historical figures only), ABCI Securities estimates

The increase in smelting and casting designed and effective capacity will allow the group to reduce the reliance of the external sourcing of steel billets which are used in the rolling production lines. The group will add a new rolling production line in Q2 2012. Demand for steel billets from rolling lines will increase subsequently. The effective smelting capacity/effective rolling capacity ratio increased from 10.3% in FY09 to 37.5% in FY10 and 59.0% for the first nine months of FY11. The increase in the ratio indicates the group was able to reduce the reliance of the external sourcing of steel billets. We expect that the ratio to increase to 59.9% for FY11 and will decline to 57.1% for FY12 as the new large bar rolling line commence operation in FY12. We believe the reducing reliance of the external sourcing of steel billets will enhance the cost advantage of the group.

Smelting & casting lines/rolling lines

FY end Dec 31	2008	2009	2010	2011	2012F	2013F	2014F
Designed smelting capacity/rolling capacity	0.0%	31.3%	31.3%	62.5%	57.1%	71.4%	85.7%
Effective smelting capacity/ effective rolling capacity	0.0%	10.3%	37.5%	59.9%	57.1%	71.4%	85.7%
Smelting production/rolling production	0.0%	5.6%	42.5%	60.0%	57.0%	60.0%	72.0%

Remark: Effective capacity is calculated based on the designed annual capacity divided by 12 and multiplied by the number of months that such production line had been in normal operation during the year.

Source: Xiwang (for historical figures only), ABCI Securities estimates



Financial Forecast

Our assumptions have been taken the following factors into the consideration.

- the industry reports prepared by CRU
- the economic outlook in the PRC where is the major market of Xiwang
- the Shandong provincial government policy
- the competitive landscape of the markets
- the business model and business strategies of Xiwang

Sales Volume and Selling Price Assumptions

FY	2008	2009	2010	2011	2012F	2013F	2014F
Sales volume ('000 tonnes)							
Ordinary steel:							
Rebars	984.0	968.0	623.4	500.6	450.5	360.4	288.3
Wire rods	0.0	260.7	734.8	737.5	700.7	700.7	700.7
Total ordinary steel	984.0	1,228.7	1,358.2	1,238.2	1,151.2	1,061.1	989.0
Chg(YoY)	-	24.9%	10.5%	-8.8%	-7.0%	-7.8%	-6.8%
Special steel:							
Quality carbon steel	0.0	0.0	90.1	626.9	689.6	689.6	793.0
Alloy structural steel	0.0	0.0	15.7	27.0	29.7	29.7	38.6
Bearing steel	0.0	0.0	0.4	52.5	57.7	57.7	69.3
Steel welding wire	0.0	0.0	8.5	3.9	4.1	4.1	4.5
Gear steel	0.0	0.0	0.0	0.0	450.0	549.0	587.4
High-duty alloy pipes	0.0	0.0	0.0	0.0	0.0	100.0	500.0
Total special steel	0.0	0.0	114.7	710.2	1,231.1	1,430.1	1,992.8
Chg(YoY)	-	-	-	519.0%	73.3%	16.2%	39.3%
Total steel	984.0	1,228.7	1,473.0	1,948.4	2,382.3	2,491.2	2,981.8
Chg(YoY)	-	24.9%	19.9%	32.3%	22.3%	4.6%	19.7%
Average selling price (Rmb/tonne)							
Ordinary steel:							
Rebars	3,835.1	2,982.4	3,438.8	4,039.4	3,716.2	3,790.5	3,866.3
Wire rods	0.0	3,269.5	3,789.6	4,388.9	3,950.0	4,029.0	4,109.6
Total ordinary steel	3,835.1	3,043.3	3,628.6	4,247.6	3,858.5	3,948.0	4,038.7
Chg(YoY)	-	-20.6%	19.2%	17.1%	-9.2%	2.3%	2.3%
Special steel:							
Quality carbon steel	-	-	3,604.6	4,473.7	4,384.2	4,603.4	4,833.6
Alloy structural steel	-	-	3,839.5	4,583.9	4,492.3	4,716.9	4,952.7
Bearing steel	-	-	4,474.9	4,899.5	4,801.5	5,041.6	5,293.7
Steel welding wire	-	-	3,884.1	4,449.9	4,360.9	4,578.9	4,807.9
Gear steel	-	-	-	-	4,345.1	4,562.3	4,790.4
High-duty alloy pipes	-	-	-	-	-	6,700.0	7,035.0
Total special steel	-	-	3,660.7	4,509.2	4,392.0	4,754.2	5,391.4
Chg(YoY)	-	-	-	23.2%	-2.6%	8.2%	13.4%
Total steel	3,835.1	3,043.3	3,631.1	4,342.9	4,134.2	4,410.8	4,942.7
Chg(YoY)	-	-20.6%	19.3%	19.6%	-4.8%	6.7%	12.1%

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Unit Cost Assumptions

FY	2008	2009	2010	2011	2012F	2013F	2014F
Unit cost of sales by product line (Rmb'000/ton)							
Ordinary steel:							
Rebars	3,726.1	2,843.6	3,262.5	3,687.9	3,442.1	3,518.6	3,606.5
Wire rods	-	2,899.0	3,185.3	3,808.0	3,490.7	3,564.2	3,643.4
Total ordinary steel	3,726.1	2,855.3	3,220.7	3,759.5	3,471.7	3,548.7	3,632.6
Chg(YoY)		-23.4%	12.8%	16.7%	-7.7%	2.2%	2.4%
Special steel:							
Quality carbon steel	-	-	3,416.4	3,601.3	3,553.3	3,701.4	3,896.2
Alloy structural steel	-	-	3,579.6	3,607.6	3,571.5	3,690.5	3,884.8
Bearing steel	-	-	4,337.9	3,728.5	3,691.2	3,814.3	4,015.0
Steel welding wire	-	-	3,135.4	3,246.6	3,506.3	3,541.4	3,727.8
Gear steel	-	-	-	-	3,550.0	3,711.4	3,906.7
High-duty alloy pipes	-	-	-	-	-	5,400.0	5,684.2
Total special steel	-	-	3,421.6	3,609.0	3,558.8	3,827.9	4,351.4
Chg(YoY)				5.5%	-1.4%	7.6%	13.7%
Total steel	3,726.1	2,855.3	3,236.4	3,704.6	3,516.7	3,708.9	4,113.0
Chg(YoY)		-23.4%	13.3%	14.5%	-5.1%	5.5%	10.9%

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates

Composition of Cost of Sales

FY ended Dec 31	2010	2011
Total cost of sales (Rmbmn)	4,786.3	7,248.0
Cost items/Cost of Sales		
Raw materials:		
Steel billets	57.0%	43.0%
Steel scraps	20.5%	24.7%
Molten iron	8.4%	15.7%
Pig iron	3.6%	2.9%
Coal & ancillary materials	4.0%	7.7%
Raw materials	93.5%	93.9%
Electricity	3.8%	3.3%
Depreciation	1.6%	1.5%
Labor costs	1.0%	1.1%
Others	0.1%	0.2%
Total cost of sales	100.0%	100.0%

Source: Xiwang (for historical figures only), ABCI Securities estimates

Absolute Cost Change of Major Raw Materials

FY ended Dec 31	2010	2011
Average prices for our major raw materials (Rmb/tonne)		
Steel billets	3,038	3,535
Steel scraps	2,179	2,353
Molten iron	3,021	3,288
Pig iron	3,161	3,305
Change of average prices of major raw materials (YoY)		
Steel billets	15.1%	16.4%
Steel scraps	22.0%	8.0%
Molten iron	-14.1%	8.8%
Pig iron	56.5%	4.6%

Source: Xiwang (for historical figures only), ABCI Securities estimates

After the installation and commencement of operation of the second EAF line in 2011, the group is able to produce more steel billets for internal consumption. The cost structure of the group in FY2011 is able to reflect the latest production flow of the group. Raw materials accounted for 93.9% of

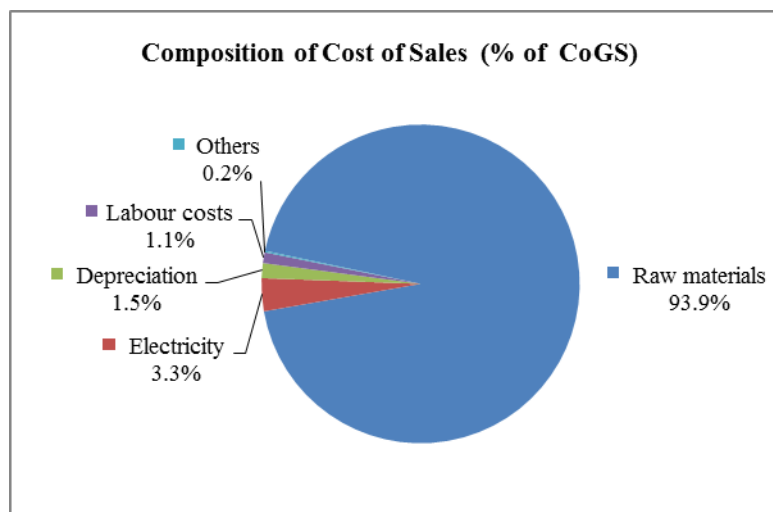


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total cost of sales for FY2011. Electricity, depreciation, direct labour and others accounted for 3.3%, 1.5%, 1.1% and 0.2% of total CoGS for FY2011 respectively. Hence, the gross profit of the group is very sensitive to the change of raw material costs. Among major raw materials, steel billets, steel scraps, molten iron, pig iron and coal & ancillary materials accounted for 45.8%, 26.3%, 16.7%, 3.1% and 8.2% of total cost of sales for FY2011.

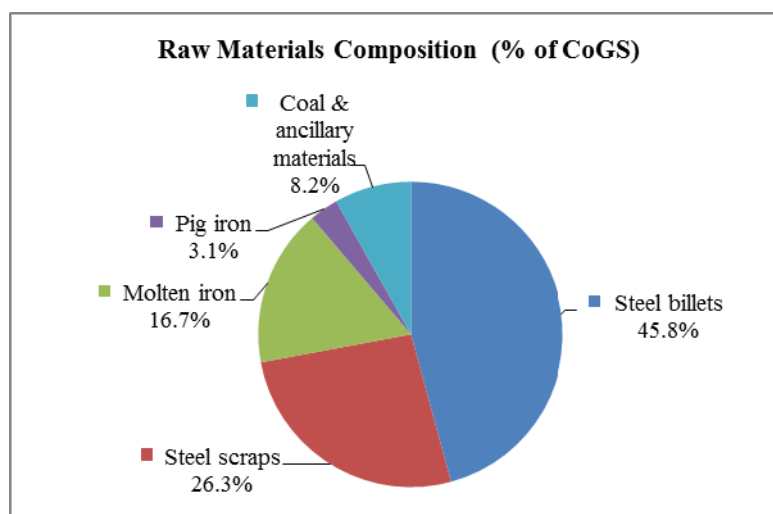
Steel billets are major raw materials of the group's downstream rolling production line. Whereas, steel scraps, molten iron, pig iron and coal & ancillary materials are major raw materials of the group's upstream smelting production line. If the group increases the output of steel billets from smelting production line, the group is able to reduce the external sourcing of steel billets. For the first nine months of 2011, the value gap between average external sourcing price of steel billets and internal production cost was approx. Rmb320/tonne (vs Rmb433/tonne in FY2010).

FY2011 Cost Structure



Source: Xiwang

FY2011 Cost Structure



Source: Xiwang



Profit Forecast

FY ended Dec 31 (Rmbmn)	2008	2009	2010	2011	2012F	2013F	2014F
Revenue breakdown:							
Ordinary steel:							
Rebars	3,773.7	2,886.9	2,143.9	2,022.1	1,674.3	1,366.2	1,114.8
Wire rods	0.0	852.4	2,784.6	3,237.0	2,767.6	2,823.0	2,879.4
Total ordinary steel	3,773.7	3,739.3	4,928.5	5,259.1	4,441.9	4,189.2	3,994.3
Special steel:							
Quality carbon steel	0.0	0.0	324.9	2,804.4	3,023.2	3,174.3	3,833.0
Alloy structural steel	0.0	0.0	60.4	123.9	133.5	140.2	191.4
Bearing steel	0.0	0.0	1.9	257.1	277.1	291.0	366.6
Steel welding wire	0.0	0.0	32.8	17.3	17.8	18.7	21.6
Gear steel	0.0	0.0	0.0	0.0	1,955.3	2,504.7	2,814.0
High-duty alloy pipes	0.0	0.0	0.0	0.0	0.0	670.0	3,517.5
Total special steel	0.0	0.0	420.0	3,202.6	5,406.8	6,798.9	10,744.1
Total ordinary & special steel	3,773.7	3,739.3	5,348.5	8,461.7	9,848.8	10,988.1	14,738.4
Others:							
Sales of by products	69.4	29.0	38.8	79.3	88.6	98.9	132.6
Metal construction services	15.2	8.7	0.0	0.0	0.0	0.0	0.0
Others	84.6	37.7	38.8	79.3	88.6	98.9	132.6
Total revenue	3,858.3	3,776.9	5,387.3	8,541.0	9,937.4	11,087.0	14,871.0
Gross profit breakdown:							
Ordinary steel:							
Rebars	107.2	134.4	109.9	175.9	123.5	98.0	74.9
Wire rods	0.0	96.6	444.1	428.4	321.8	325.7	326.6
Sub-total ordinary steel	107.2	231.0	554.0	604.3	445.3	423.7	401.6
Special steel:							
Quality carbon steel	0.0	0.0	17.0	546.9	573.0	622.0	743.4
Alloy structural steel	0.0	0.0	4.1	26.4	27.4	30.5	41.3
Bearing steel	0.0	0.0	0.0	61.4	64.1	70.8	88.6
Steel welding wire	0.0	0.0	6.3	57.4	3.5	4.2	4.8
Gear steel	0.0	0.0	0.0	0.0	357.8	467.2	519.1
High-duty alloy pipes	0.0	0.0	0.0	0.0	0.0	130.0	675.4
Sub-total special steel	0.0	0.0	27.4	639.4	1,025.7	1,324.8	2,072.6
Total ordinary & special steel	107.2	231.0	581.4	1,243.7	1,471.0	1,748.5	2,474.1
Others:							
By products	10.7	15.3	19.5	49.3	53.2	59.3	79.6
Metal construction services	7.7	0.2	0.0	0.0	0.0	0.0	0.0
Others	18.4	15.5	19.5	49.3	53.2	59.3	79.6
Total gross profit	125.6	246.5	601.0	1,293.0	1,524.2	1,807.8	2,553.7
Other income & gains	23.8	23.7	45.1	16.5	10.0	6.0	8.0
Selling & distribution costs	(2.8)	(4.5)	(4.3)	(5.4)	(7.0)	(7.8)	(10.4)
Admin expenses	(9.1)	(13.8)	(19.5)	(58.2)	(81.6)	(71.0)	(95.2)
Other expenses	(0.9)	(0.4)	(1.1)	(0.5)	(0.5)	(0.6)	(0.7)
Finance costs	(31.2)	(13.3)	(24.8)	(57.4)	(103.3)	(75.9)	(45.5)
Pre-tax profit	105.4	238.2	596.4	1,187.8	1,341.9	1,658.7	2,409.9
Tax	(25.7)	(39.3)	(103.6)	(278.5)	(295.2)	(364.9)	(530.2)
Net profit to the group	79.7	198.9	492.8	909.3	1,046.7	1,293.8	1,879.7
Net profit attributable to							
The equity holders of the company	43.5	194.1	492.8	909.3	1,046.7	1,293.8	1,879.7
The non-controlling interests	36.3	4.8	0.0	0.0	0.0	0.0	0.0

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Revenue and Gross Profit Composition

FY ended Dec 31	2008	2009	2010	2011	2012F	2013F	2014F
Revenue composition:							
Ordinary steel:							
Rebars	97.8%	76.4%	39.8%	23.7%	16.8%	12.3%	7.5%
Wire rods	0.0%	22.6%	51.7%	37.9%	27.9%	25.5%	19.4%
Total ordinary steel	97.8%	99.0%	91.5%	61.6%	44.7%	37.8%	26.9%
Special steel:							
Quality carbon steel	0.0%	0.0%	6.0%	32.8%	30.4%	28.6%	25.8%
Alloy structural steel	0.0%	0.0%	1.1%	1.5%	1.3%	1.3%	1.3%
Bearing steel	0.0%	0.0%	0.0%	3.0%	2.8%	2.6%	2.5%
Steel welding wire	0.0%	0.0%	0.6%	0.2%	0.2%	0.2%	0.1%
Gear steel	0.0%	0.0%	0.0%	0.0%	19.7%	22.6%	18.9%
High-duty alloy pipes	0.0%	0.0%	0.0%	0.0%	0.0%	6.0%	23.7%
Total special steel	0.0%	0.0%	7.8%	37.5%	54.4%	61.3%	72.2%
Total ordinary & special steel	97.8%	99.0%	99.3%	99.1%	99.1%	99.1%	99.1%
Others:							
Sales of by products	1.8%	0.8%	0.7%	0.9%	0.9%	0.9%	0.9%
Metal construction services	0.4%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%
Others	2.2%	1.0%	0.7%	0.9%	0.9%	0.9%	0.9%
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross profit composition:							
Ordinary steel:							
Rebars	85.4%	54.5%	18.3%	13.6%	8.1%	5.4%	2.9%
Wire rods	0.0%	39.2%	73.9%	33.1%	21.1%	18.0%	12.8%
Sub-total ordinary steel	85.4%	93.7%	92.2%	46.7%	29.2%	23.4%	15.7%
Special steel:							
Quality carbon steel	0.0%	0.0%	2.8%	42.3%	37.6%	34.4%	29.1%
Alloy structural steel	0.0%	0.0%	0.7%	2.0%	1.8%	1.7%	1.6%
Bearing steel	0.0%	0.0%	0.0%	4.8%	4.2%	3.9%	3.5%
Steel welding wire	0.0%	0.0%	1.0%	4.4%	0.2%	0.2%	0.2%
Gear steel	0.0%	0.0%	0.0%	0.0%	23.5%	25.8%	20.3%
High-duty alloy pipes	0.0%	0.0%	0.0%	0.0%	0.0%	7.2%	26.4%
Sub-total special steel	0.0%	0.0%	4.6%	49.4%	67.3%	73.3%	81.2%
Total ordinary & special steel	85.4%	93.7%	96.7%	96.2%	96.5%	96.7%	96.9%
Others:							
By products	8.5%	6.2%	3.3%	3.8%	3.5%	3.3%	3.1%
Metal construction services	6.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Others	14.6%	6.3%	3.3%	3.8%	3.5%	3.3%	3.1%
Total gross profit	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Balance Sheet Forecast

As of Dec 31 (Rmbmn)	Pre-IPO				Post-IPO		
	2008	2009	2010	2011	2012F	2013F	2014F
Non-current assets							
Property, plant and equipment	594.5	1,563.2	2,138.6	3,269.5	3,967.0	3,975.4	3,800.4
Prepaid land lease payments	4.5	0.0	155.7	94.9	93.2	91.4	89.7
Deferred tax assets	1.0	0.0	0.0	1.4	2.1	2.2	2.2
Total non-current assets	600.0	1,563.2	2,294.3	3,365.8	4,062.2	4,069.0	3,892.2
Current assets							
Inventories	259.7	367.7	306.8	421.9	730.6	540.5	1,146.8
Trade and bills receivables	6.5	23.8	57.1	547.6	541.4	612.8	935.4
Prepayments, deposits and other receivables	252.4	306.1	192.7	498.2	374.5	582.5	685.8
Due from fellow subsidiaries	10.2	7.1	11.0	0.0	0.0	0.0	0.0
Pledged deposits	30.0	1,560.9	210.0	745.0	345.8	381.3	506.2
Cash and cash equivalents	49.5	25.6	72.5	154.5	1,268.6	2,373.0	4,187.6
Total current assets	608.2	2,291.2	850.1	2,367.2	3,260.9	4,490.2	7,461.8
Total assets	1,208.3	3,854.4	3,144.4	5,733.0	7,323.2	8,559.2	11,354.0
Current liabilities							
Trade and bills payables	80.0	1,720.1	206.4	1,578.9	1,924.7	1,939.5	2,650.0
Receipts in advance, other payables and accruals	387.4	733.0	510.1	536.5	296.3	223.7	464.1
Interest-bearing bank and other borrowings	243.9	570.2	941.2	644.5	500.0	1,000.0	500.0
Due to the ultimate holding company	55.6	319.6	384.2	0.0	0.0	0.0	0.0
Due to the immediate holding company	108.4	120.6	132.3	0.0	0.0	0.0	0.0
Due to fellow subsidiaries	57.8	3.4	67.9	0.0	0.0	0.0	0.0
Due to a related party	42.6	22.0	0.0	0.0	0.0	0.0	0.0
Income tax payable	19.8	15.2	53.8	53.2	118.1	146.0	212.1
Total current liabilities	995.3	3,504.1	2,295.9	2,813.0	2,839.1	3,309.1	3,826.1
Non-current liabilities							
Interest-bearing bank and other borrowings	35.2	0.0	0.0	1,000.0	1,000.0	0.0	0.0
Deferred tax liability	0.0	0.0	0.0	27.3	0.0	0.0	0.0
Total non-current liabilities	35.2	0.0	0.0	1,027.3	1,000.0	0.0	0.0
Total liabilities	1,030.5	3,504.1	2,295.9	3,840.2	3,839.1	3,309.1	3,826.1
Equity attributable to owners of the co	78.5	350.3	848.5	1,892.7	3,484.1	5,250.1	7,527.9
Non-controlling interests	99.2	0.0	0.0	0.0	0.0	0.0	0.0
Total equity	177.8	350.3	848.5	1,892.7	3,484.1	5,250.1	7,527.9
Cash and cash equivalents (excl. pledged deposits)	49.5	25.6	72.5	154.5	1,268.6	2,373.0	4,187.6
Less: Total interest bearing bank & other borrowings	279.0	570.2	941.2	1,644.5	1,500.0	1,000.0	500.0
Net cash (debt), excluding pledged deposits	(229.6)	(544.6)	(868.7)	(1,490.0)	(231.4)	1,373.0	3,687.6
Net cash (debt), including pledged deposits	(199.6)	1,016.3	(658.7)	(745.0)	114.4	1,754.3	4,193.8
Pro-forma issued shares (mn)	1,600.0	1,600.0	1,600.0	1,600.0	2,000.0	2,000.0	2,000.0
NBV (Rmb/share)	0.049	0.219	0.530	1.183	1.742	2.625	3.764

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Cash Flow Forecast Summary

FY ended Dec 31 (Rmbmn)	2008	2009	2010	2011	2012F	2013F	2014F
CASH FLOWS FROM OPERATING ACTIVITIES							
Pre-tax profit	105.4	238.2	596.4	1,187.8	1,341.9	1,658.7	2,409.9
Adjustments for:							
Finance costs	31.2	13.3	24.8	57.4	103.3	75.9	45.5
Interest income from the ultimate holding company	(18.4)	(8.4)	0.0	0.0	0.0	0.0	0.0
Bank interest income	(0.5)	(8.4)	(5.0)	(13.1)	(10.0)	(6.0)	(8.0)
Exchange (gain)/loss, net	(4.3)	0.1	0.0	(2.2)	0.0	0.0	0.0
Gain on disposal of prepaid land lease payments	0.0	(3.8)	0.0	0.0	0.0	0.0	0.0
Depreciation	15.7	20.4	76.7	110.5	147.6	171.6	175.0
Amortisation of prepaid land lease payments	0.1	0.0	1.3	1.8	1.7	1.7	1.7
Loss on disposal of a subsidiary	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Subtotal	129.2	251.5	695.0	1,342.2	1,584.5	1,901.9	2,624.2
Change in inventories	38.0	(177.5)	65.9	(115.1)	(308.7)	190.0	(606.2)
Change in trade and bills receivables	6.9	(33.6)	(33.4)	(490.5)	6.2	(71.4)	(322.6)
Change in prepayments, deposits and other receivables	81.3	(45.2)	107.0	(303.7)	123.7	(208.0)	(103.3)
Change in due from fellow subsidiaries	6.7	3.0	(3.9)	11.0	0.0	0.0	0.0
Change in trade and bills payables	13.1	1,647.3	(343.7)	1,372.5	345.8	14.8	710.5
Change in receipts in advance, other payables and accruals	(38.9)	(206.3)	182.0	65.4	(240.2)	(72.6)	240.4
Change in due to fellow subsidiaries	53.6	(54.3)	(482.7)	(67.9)	0.0	0.0	0.0
Change in due to a related party	(39.6)	27.7	(15.7)	0.0	0.0	0.0	0.0
Cash generated from/(used in) operations	250.4	1,412.7	170.5	1,813.9	1,511.4	1,754.7	2,543.0
Interest received	18.8	10.7	5.4	7.8	9.0	5.4	7.2
PRC tax paid	(29.2)	(42.9)	(64.9)	(253.2)	(265.7)	(328.4)	(477.2)
Net cash flows from/(used in) operating activities	240.1	1,380.4	111.1	1,568.5	1,254.7	1,431.7	2,073.0
CASH FLOWS FROM INVESTING ACTIVITIES							
Purchase of property, plant and equipment	(258.9)	(381.5)	(1,023.2)	(1,276.5)	(1,348.6)	(180.0)	0.0
Purchase of prepaid land lease payments	0.0	0.0	(160.2)	0.0	0.0	0.0	0.0
Disposal of metal construction business	0.0	(0.5)	0.0	0.0	0.0	0.0	0.0
Refunds of prepaid land lease payment	0.0	0.0	0.0	60.3	0.0	0.0	0.0
Proceeds from disposal of P.P.E.	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Disposal of a subsidiary	0.0	0.0	(2.1)	0.0	0.0	0.0	0.0
Change in pledged deposits	10.0	(1,530.9)	280.9	(535.0)	399.2	(35.6)	(124.9)
Net cash flows used in investing activities	(248.9)	(1,912.9)	(904.6)	(1,750.7)	(949.4)	(215.6)	(124.9)
CASH FLOWS FROM FINANCING ACTIVITIES							
Net proceeds of new issues	0.0	0.0	0.0	0.0	804.7	0.0	0.0
Change in due to the ultimate holding company	19.9	272.3	164.6	(384.2)	0.0	0.0	0.0
Change in due to the immediate holding company	78.7	(14.0)	11.7	0.0	0.0	0.0	0.0
Repayments of other loans	(17.1)	(24.7)	(20.4)	0.0	0.0	0.0	0.0
Interest paid	(41.0)	(40.7)	(42.2)	(57.4)	(70.3)	(75.9)	(45.5)
Dividends paid	0.0	0.0	0.0	0.0	(274.0)	(314.0)	(388.1)
Repayment & new bank loans, net	(6.0)	315.8	721.4	703.3	1,153.1	278.1	300.1
Net cash flows from financing activities	34.5	508.7	835.1	261.6	808.8	(111.8)	(133.6)
Net change in cash & equivalents	25.6	(23.8)	41.6	79.4	1,114.1	1,104.3	1,814.6
Cash and cash equivalents at beginning of period	23.2	49.5	25.6	72.5	154.5	1,268.6	2,373.0
Effect of foreign exchange rate changes, net	0.6	(0.1)	5.4	2.6	-	-	-
Cash and cash equivalents at the end of period	49.5	25.6	72.5	154.5	1,268.6	2,373.0	4,187.6

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Financial Ratio Analysis

FY ended Dec 31	2008	2009	2010	2011	2012F	2013F	2014F
Profitability ratio							
Gross profit margin	3.26%	6.53%	11.16%	15.14%	15.34%	16.31%	17.17%
EBIT margin	2.95%	6.04%	10.71%	14.39%	14.45%	15.60%	16.46%
EBITDA margin	3.36%	6.59%	12.16%	15.67%	15.95%	17.16%	17.65%
Pre-tax profit margin	2.73%	6.31%	11.07%	13.91%	13.50%	14.96%	16.21%
Net profit margin	2.07%	5.27%	9.15%	10.65%	10.53%	11.67%	12.64%
ROAA		7.86%	14.08%	20.49%	16.03%	16.29%	18.88%
ROAE		90.52%	82.21%	66.34%	38.93%	29.63%	29.42%
Sales/average assets	-	1.49	1.54	1.92	1.52	1.40	1.49
Cost ratio							
Selling & distribution costs/revenue	0.07%	0.12%	0.08%	0.06%	0.07%	0.07%	0.07%
Admin expenses/revenue	0.24%	0.36%	0.36%	0.68%	0.64%	0.64%	0.64%
Other expenses/revenue	0.02%	0.01%	0.02%	0.01%	0.01%	0.01%	0.01%
Finance costs/revenue	0.81%	0.35%	0.46%	0.67%	1.04%	0.68%	0.31%
Effective tax rate	24.35%	16.49%	17.37%	23.45%	22.00%	22.00%	22.00%
Leverage							
Current ratio	0.61	0.65	0.37	0.84	1.15	1.36	1.95
Quick ratio	0.35	0.55	0.24	0.69	0.89	1.19	1.65
Total equity/total assets	14.7%	9.1%	27.0%	33.0%	47.6%	61.3%	66.3%
Net bank loans/total equity	129.1%	155.5%	102.4%	78.7%	6.6%	Net cash	Net cash
ST bank loans/total bank loans	87.4%	100.0%	100.0%	39.2%	33.3%	100.0%	100.0%
Repayment capability							
EBITDA/Pre-capitalized finance costs	3.16	6.12	15.51	14.09	15.34	25.07	57.66
EBITDA/(ST bank loans + pre-capitalized finance costs)	0.45	0.41	0.67	1.81	2.63	1.77	4.81
Working capital cycle							
Inventory turnover days	26.80	32.43	25.72	18.35	25.00	25.00	25.00
Trade receivables turnover days	0.70	0.27	0.48	0.96	1.00	1.00	1.00
Bills receivables turnover days		1.19	2.26	11.96	19.00	18.00	18.00
Trade payables turnover days	1.70	3.25	5.31	7.13	8.00	8.00	8.00
Bills payables turnover days		89.80	68.14	37.82	68.00	68.00	60.00
Customers concentration							
Sales to 5 largest customers/total revenue	31.0%	31.1%	36.8%	40.7%	-	-	-
Sales to the largest customers/total revenue	9.0%	8.7%	13.1%	15.2%	-	-	-
% of sales to distributors to total revenue	99.3%	97.6%	87.7%	N/A	-	-	-
Suppliers concentration							
Purchases from 5 largest suppliers/total cost of purchases	94.5%	84.5%	60.5%	59.9%	-	-	-
Purchases from the largest suppliers/total cost of purchases	81.9%	49.8%	23.2%	14.7%	-	-	-
Purchases from top 3 billet suppliers/total purchases of steel billets from third parties	97.4%	88.3%	72.0%	N/A	-	-	-
% of total steel billet requirements from third party suppliers	100.0%	95.5%	60.8%	N/A	-	-	-
% of total steel billet requirements from in-house production	0.0%	4.5%	39.2%	N/A	-	-	-

ROAA= Net profit to the Group/average total assets

ROAE= Net profit to the equity owners of the company/average attributable equity to the owners of the company

EBITDA=EBIT + Depreciation & amortization

EBIT= Earnings before interest income, other income and expenses, finance cost and tax

Average trade receivable turnover (days) is equal to the average trade receivable divided by revenue and multiplied by 365 days. Average inventory turnover (days) is equal to the average inventory divided by costs of sales and multiplied by 365 days. Average trade payable turnover (days) is equal to the average trade payable divided by cost of sales and multiplied by 365 days.

F: ABCI Securities estimates

Source: Xiwang (for historical figures only), ABCI Securities estimates



Sector Comparison

Profitability Comparison

Ticker	Company	Latest FY end	Gross profit margin (%)	EBITDA margin (%)	ROAA (%)	ROAE (%)
HK-listed ordinary steel peers						
347 HK Equity*	ANGANG STEEL	12/2011	0.98	5.44	-2.22	-4.13
323 HK Equity*	MAANSHAN IRON & STEEL	12/2011	3.75	7.00	0.09	0.26
1053 HK Equity*	CHONGQING IRON & STEEL CO	12/2011	3.98	-	-5.92	-29.46
HK-listed special steel peer						
1266 HK Equity	Xiwang (pre-listing status)	12/2011	15.14	15.67	20.49	66.34
267 HK Equity	CITIC PACIFIC LTD , of which CITIC Pacific Special Steel	12/2011	14.22	9.43	4.37	12.88
China A-share ordinary steel peers						
600019 CH Equity	BAOSHAN IRON & STEEL	12/2011	8.51	9.64	3.29	6.97
600022 CH Equity	SHANDONG IRON AND STEEL	12/2011	7.58	6.83	0.17	0.73
China A-share special steel peers						
600117 CH Equity	XINING SPECIAL STEEL	12/2011	19.53	19.50	2.55	11.96
000708 CH Equity	DAYE SPECIAL STEEL CO LTD	12/2011	8.31	8.09	12.66	21.51
600507 CH Equity	FANGDA SPECIAL STEEL TECH	12/2011	10.22	10.75	8.31	29.67
600399 CH Equity	FUSHUN SPECIAL STEEL	12/2011	7.48	8.38	0.53	1.89
002318 CH Equity	ZHEJIANG JIULI HI-TECH	12/2011	15.72	10.64	5.01	7.85
002423 CH Equity	ZHONGYUAN SPECIAL STEEL	12/2011	15.06	-	3.37	4.95

Note*: Angang Steel, Maanshan Iron and Chongqing Iron are also listed in the China A-share markets.

EBITDA margin = Profit before tax, net interest expenses, depreciation and amortization

Source: Xiwang, Bloomberg, ABCI Securities estimates

When we identify the comparable peers of Xiwang, we consider the Xiwang was transforming from ordinary steel player to special steel player in FY10 and FY11. However, Xiwang is neither a pure ordinary steel play nor a pure special steel play. We expect its proportion of special steel business to increase further in coming years.

Angang Steel (347), Maanshan Iron (323) and Chongqing Iron (1053) are mainly engaged in the production of ordinary steel. CITIC Pacific (267) has a large portion of business in special steel production. According to the annual report of CITIC Pacific, its production capacity of special steel reached 9mn tonnes per annum and it produced 6.96mn tonnes of special steel in 2011. CITIC Pacific is also comparable to Xiwang, but the former also has diversified businesses.

We also consider the ordinary steel producers and special steel producers listed in the China stock markets. We identify six special steel production stocks listed in the China stock markets.

When we compare the profitability of Xiwang with our identified comparable peers, Xiwang achieved relatively good profitability (measured in terms of gross profit margin, EBITDA margin, ROAA and ROAE) than its peers. We believe outstanding performance of Xiwang is due to the following reasons.

- Xiwang succeeded in integrated its smelting production line to lower the cost of production. Xiwang reduced proportion of low margin business (ordinary steel) and increased the proportion of high margin business (special steel). Hence, its gross profit margin and EBITDA margin were



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above average of comparable peer groups.

- Xiwang achieved very high production utilization rate in the period of our comparison, hence, it could be more selective in obtaining new orders. Thus, its ROAA was higher than average of its comparable groups.
- Xiwang is a privatized company with relatively low equity/assets ratio, whereas as its comparable peers are listed company with relatively high equity/assets ratio. Thus, its ROAE was higher than average of its comparable groups.



Valuation

We appraise the equity of the group in two different approaches. We use comparison method to evaluate the group against the market valuation of comparable peers. We also use the discount cash flow method to value the equity value of the group.

Valuation Summary

Valuation method	Range of equity value Rmb/share	Range of equity value HK\$/share	Corresponding FY2012 PER range
PER rating	3.14-3.92	3.87-4.83	6.00-7.50
Discount cash flow (WACC:18.0-20.5%)	3.35-4.02	4.12-4.95	6.40-7.68
Combined range	3.14-4.02	3.87-4.95	6.00-7.68

@Rmb0.8123/HK\$; Source: ABCI Securities estimates

Market Valuation Comparison

Ticker	Company	Curr	Price*	Latest FY end	FY2011 PER (x)	Estimate FY2012 PER (x)	Historical P/B (x)
Hang Seng Composite – Materials index			7,135.17	12/2011	9.0	7.7	1.13
HK-listed ordinary steel peers							
347 HK Equity	ANGANG STEEL	HK\$	5.36	12/2011	Loss	44.9	0.59
323 HK Equity	MAANSHAN IRON & STEEL	HK\$	2.43	12/2011	372.4	21.2	0.56
1053 HK Equity	CHONGQING IRON & STEEL	HK\$	1.38	12/2011	Loss	34.0	0.35
HK-listed special steel peers							
1266 HK Equity	XIWANG SPECIAL STEEL	HK\$	2.16	12/2011	3.1	3.4	1.48
267 HK Equity	CITIC PACIFIC LTD	HK\$	13.00	12/2011	5.1	7.5	0.63
China A-share ordinary steel peers							
600019 CH Equity	BAOSHAN IRON & STEEL	Rmb	4.79	12/2011	11.3	7.7	0.79
600022 CH Equity	SHANDONG IRON AND STEEL	Rmb	2.95	12/2011	174.6	12.8	1.28
China A-share special steel peers							
600117 CH Equity	XINING SPECIAL STEEL	Rmb	6.70	12/2011	15.3	11.8	1.73
000708 CH Equity	DAYE SPECIAL STEEL CO LTD	Rmb	10.84	12/2011	8.3	8.3	1.68
600507 CH Equity	FANGDA SPECIAL STEEL TECH	Rmb	4.55	12/2011	8.2	8.3	2.11
600399 CH Equity	FUSHUN SPECIAL STEEL	Rmb	5.46	12/2011	108.6	28.0	1.69
002318 CH Equity	ZHEJIANG JIULI HI-TECH	Rmb	16.47	12/2011	30.9	20.6	2.33
002423 CH Equity	ZHONGYUAN SPECIAL STEEL	Rmb	7.70	12/2011	40.2	-	1.96

*: The share prices were dated on Apr 10, 2012

Source: Bloomberg, ABCI Securities estimates

PER rating method

When we evaluate Xiwang, we believe that its business composition will affect its valuation. In particular, we expect that its future business growth potential in special steel business is tremendous. Moreover, proportion of revenue from low margin ordinary steel business is reducing and proportion of revenue from high margin of special steel business is increasing.

Furthermore, Xiwang is in growth stage during 2011-12 as new smelting production line was added in FY11 and a new large bar rolling line is expected to commence production in FY12. The earnings growth in coming years is primarily derived from its special steel business. We'd better compare Xiwang with special steel plays in the industry such as CITIC Pacific and



other special steel plays in the China stock markets.

The ordinary steel makers such as Angang (347), Maanshan Iron (323) and Chongqing Iron (1053) are classified into Hang Seng Composite- Materials index (Bloomberg ticker: HSCIMT)(Apr 10, 2012 closing: 7,135.17) which is trading at historical FY11 PER of 9.0x and estimated FY12 PER of 7.7x. The index is at FY11 P/B of 1.13x or est. FY12 P/B of 0.96x. The benchmark index valuation also provides reference to our evaluation.

Among three H-share steel makers listed in HK, Angang and Chongqing Iron reported net losses for FY2011. Market is cautious on steel industry. Although Xiwang reported strong profit growth for FY2011, Xiwang has short listing track record. In the short-term, the stock is justified to trade at discount to its benchmark reference index (i.e. HSCIMT Index).

Based on our predicted net profit for FY12, we project the FY12 PER range of Xiwang at 6.0-9.0 with average value at 7.5x. To be conservative, we rate Xiwang at lower bound of the FY12 PER range, ie. 6.0-7.5x, based on PER rating of comparable peers.

Discount cash flow method

We also appraise the group based on the discount cash flow method. The group is expanding its production capacities during the period of 2011-13. Based on the existing expansion plan of the group and our forecast, we expect the growth momentum of the group will flatten beyond FY2014 unless the group has new expansion plan beyond FY2014.

Yr to Dec 31 (Rmbmn)	2011	2012F	2013F	2014F
EBITDA	1,338.5	1,585.0	1,902.4	2,624.9
Chg in WC	430.8	(73.1)	(147.2)	(81.2)
Tax paid	(219.2)	(265.7)	(328.4)	(477.2)
Capex	(1,448.6)	(1,348.6)	(180.0)	0.0
Free cash flow	101.5	(102.4)	1,246.8	2,066.5
Terminal value				10,645.6
PV of free cash flow (WACC 19.41%)	101.5	(85.8)	874.4	1,213.7
PV of terminal value (WACC 19.41%)	6,252.1			
Total PV	8,355.89			
Less: Net debt after tax effect	1,117.47			
PV of equity	7,238.43			

EBITDA: Pre-tax profit before finance cost, depreciation, amortization, and other non-operating incomes & expenses

Source: ABCI Securities estimates

Estimation of WACC

Risk-free rate (10-year HK government bond yield): 1.31%

Hong Kong market return rate: 13.279%

Average beta (Citic Pacific, Angang, Maanshan Iron, Chongqing Iron): 1.59

Debt/equity ratio: 6.6%:93.4% (post-listing)

Cost of equity: 20.36%

Cost of debt: 6.06%

WACC: 19.41%

Source: Bloomberg, ABCI Securities estimates

Based on WACC of 19.41%, we value the equity of the group at

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Rmb7,238.43mn, which represent 7.96x of FY2011 net profit or 6.92x of our expected net profit for FY12.

Prior to its listing in Feb 2012, the group relied on bank loans to run its business. Upon completion of its listing exercise, the group mainly relies on equity funds to finance its capex and future expansion plan. However, cost of equity of steel makers such as Xiwang is substantially high than its cost of bank loans. The leverage ratio of the group will significantly affect the WACC of the group. We estimate WACC of the group may be in range of 18.00-20.5%, although our based case WACC is at 19.41%. With WACC at 18.00%-20.5%, we value the equity at Rmb8,006mn- Rmb6,669mn, which represent Rmb4.02-3.35/share (base case Rmb3.62/share).

Scenario analysis

Discount rate	Implied equity value Rmbmn	Rmb/share	HK\$/share	Equity value/ FY11 net profit	Equity value/ FY12 net profit
18.00%	8,006.54	4.02	4.95	8.84	7.68
18.50%	7,708.96	3.87	4.76	8.51	7.40
19.00%	7,427.58	3.73	4.59	8.20	7.13
19.41% (base case)	7,238.43	3.62	4.46	7.96	6.92
19.50%	7,161.16	3.60	4.43	7.91	6.87
20.00%	6,908.55	3.47	4.27	7.63	6.63
20.50%	6,668.75	3.35	4.12	7.37	6.40

@Rmb0.8123/HK\$

Source: ABCI Securities estimates



Risk Factors

- **Earnings risk:** According to the survey conducted by National Bureau of Statistics of China (NBSC), total profits (operating profit + non-operating profit – operating expenses) of enterprises above designated size (i.e. annual revenue of principal business over Rmb20mn) in the ferrous metal mining and processing decreased 94% YoY for the first two months of 2012. Total profit of this industry was up 53.0% YoY in 2011. The result of the survey indicated that the profitability of steel industry declined significantly in Jan and Feb.
- **Threats to existing business practice:** Xiwang demands its customers to prepay before delivery of goods. This practice is good to reduce credit risk of Xiwang. However, the demand for Xiwang's products will be affected by the availability of the funding sources of the customers. Trade receivables turnover days rose from 0.48 day in FY10 to 0.96 day in FY11. Meanwhile, bills receivables turnover days sharply increased from 2.26 days in FY10 to 11.96 days in FY11. The sharp increase in bills receivables turnover days indicated that customers lacked cash to settle the transactions before they took delivery of goods on one hand and Xiwang relaxed its credit policy to customers on the other hand.
- **Possible sharp increase in scrap steel cost:** Scrap steel is one of major raw materials of the group's EAF-based smelting production lines, accounting for 26.3% of total cost of sales of the group for FY11. According to China Economic Information Network, the average import scrap steel price in China is in rising trend. The trend is unfavourable to Xiwang. The average import scrap steel price rose from US\$513.55/tonne in 2010 to US\$610.87/tonne, up 18.95% YoY. Average import scrap steel price climbed up further to US\$639.62/tonne for the first two months of 2012, up 18.52% YoY. Average scrap steel purchased by the group was Rmb2,179/tonne (or US\$324.40/tonne @Rmb6.717/US\$) and Rmb2,353/tonne (or US\$364.58/tonne @Rmb6.454/US\$) for FY10 and FY11 respectively. The average purchase price of scrap steel by the group was 36-40% lower than the average import price last two financial year. We estimate the group consumed approx. 760,297 tonnes of scrap steel at total cost of Rmb1,789.0mn for FY11. If the scrap steel cost were at US\$610.87/tonne (i.e. average import price of scrap steel in 2011), Xiwang's scrap steel cost would have increased to Rmb2,997.5mn, up Rmb1,208.5mn, for FY11. The additional scrap steel cost would have almost totally eroded its total gross profit of Rmb1,293.0mn for FY11. The scenario analysis indicates the group's profitability in the future is very sensitive to the change of the purchase cost of scrap steel.
- **Market development risks:** Although Xiwang has entered the ordinary steel market since 2004, the group start producing special steel in Jun 2010 and is considered as a new entrant in the special steel market. Facing competition from well-established players, Xiwang might not be able to broaden its customer base in the special steel market. Moreover, the lack of operating experience in regions outside Shandong province will pose difficulties for Xiwang to expand its geographical coverage to its targeted provinces such as Jiangsu, Henan and Anhui, in terms of availability of resources, identification of suitable customers and negotiation of acceptable terms for agreements with customers. As a result, the group might not be able to improve its profit margin through



an intended change in product mix.

- **Expansion risks:** Availability and price changes of key equipment or materials, cost and unavailability of financing, construction risks and changes in safety/environmental requirements will lead to delay and cost overruns in construction of the new bar production line. A significant delay in the completion of this production line or material increase in the cost would adversely affect the Xiwang competitive advantage in the special steel market.
- **Raw material supply risks:** The growth of steel billets production might not be able to catch up with rolling capacity and Xiwang might have to increase its purchases of steel billets from third parties. As proportion of the billets produced in-house decrease, unit cost will increase and hence lead to a decline in profit margin. If Xiwang is not able to secure a stable supply from third parties, the production plan will also be adversely affected.
- **Supplier concentration risks:** The five largest suppliers accounted for 60.5% and 59.9% for total cost of purchases in 2010 and 2011 respectively. For the same period, the largest supplier accounted for 23.2% and 14.7%, respectively for total cost of purchases. Since Xiwang is relatively reliant of only a few of raw material suppliers, failure of purchase delivery and termination of business relationship with the suppliers will have a material effect on Xiwang production.
- **Customer concentration risks:** Sales to largest five customers accounted for 40.7% (36.8% for FY10) of total revenues for FY11. Sales to the largest customer accounted for 15.2% (13.1% for FY10) of total revenues for FY11. The proportion of revenue contribution from the largest customers and top five customers increased last two financial years.
- **Lack of established relationship with existing customers:** Top ten customers accounted for 45.2%, 54.8% and 53.8% of Xiwang total revenue in 2009, 2010 and for the nine months ended 30 Sep 2011. As of 30 Sep 2011, three of the top five customers had a business relationship with Xiwang of less than three years. The lack of long term relationship with customers means that the group might not be able to secure orders in the long term in order to absorb its growing capacity.
- **Liquidity risks:** As of 31 Dec 2008, 2009, 2010 and 2011, Xiwang had net current liabilities of Rmb387.1mn, Rmb1,212.8mn, Rmb1,445.8mn and Rmb445.8mn, respectively. The net current liabilities positions expose the group to liquidity risks.
- **Funding risks:** Since steel industry is capital intensive, if cash flows from operations, bank borrowings and other external financing sources cannot meet Xiwang funding needs, the inability to raise funds from obtaining additional funds will hinder Xiwang future growth.



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