

Zhuzhou CSR Times Electric Co., Ltd.

FY14 result beat by >10%

- **ZZCSR's FY14 NPAT came in at Rmb2.4B, up 63% Y/Y, >10% ahead of our estimates and market expectations.** The earnings beat was mainly driven by better revenue (8% above JPMe) and higher gov't grants. Key highlights include:

- 1) **Better revenue was driven by sales of electrical systems for EMUs, which more than doubled Y/Y.**
- 2) **Profitability improved despite start-up losses from the IGBT plant.** Blended GP margin came in at 38%, up 2.2ppts Y/Y driven by rising contribution from higher-margin train-borne products (i.e. EMUs and locomotives), contribution of which reached 67% in 2014 (up from 59% oya). Opex-to-sales ratio dropped by 1.7ppts Y/Y, despite additional operating costs and lease expenses arising from the IGBT plant.
- 3) **Op-CF was a positive inflow of Rmb2.1B, up 183% Y/Y, likely driven by receipt of higher cash prepayments from CSR (which in turn received from CRC) for the second round of MU orders signed at year-end.**
- 4) **ZZCSR's net cash equated to cRmb3B as of end-2014, sufficient to cover the planned acquisition capex of Rmb2.5B including Rmb1.5B for the IGBT plant and Rmb1.0B for deepsea robots business.**

- **4Q14 profit growth moderated on a high base and increased start-up losses from the IGBT plant:** NPAT in the quarter edged up by 5% Y/Y on a high base (as FY13 profit was back-end loaded, with 4Q profit forming 42% of the annual result) along with increased loss from the IGBT plant (the lease expense started hitting from Sept' 14).

- **We have not yet modeled in potential asset injection from CNR as the timeline remains uncertain:** CSR/CNR merger has been progressing well, with receipt of approval from SASAC as well as respective shareholders in March. Completion of the merger is conceivable by 3Q15, with integration to take place through 2016 between the two businesses, across mgmt, R&D, procurement, production and sales channel. We have not yet modeled in the asset injection from CNR as well as potential sales to CNR, given the lack of timetable and details in relation to the acquisition.

Overweight

3898.HK, 3898 HK

Price: HK\$45.25

Price Target: HK\$40.00

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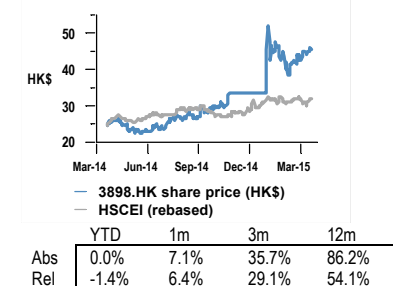
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Price Performance



Zhuzhou CSR Times Electric Co., Ltd. (Reuters: 3898.HK, Bloomberg: 3898 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Total Revenue (Rmb mn)	7,249	8,856	11,739	13,029	13,971
Net Profit (Rmb mn)	1,224	1,467	2,086	2,249	2,476
EPS (Rmb)	1.13	1.33	1.77	1.91	2.11
DPS (Rmb)	0.35	0.35	0.53	0.57	0.63
Revenue growth (%)	1.7%	22.2%	32.6%	11.0%	7.2%
EPS growth (%)	3.3%	18.1%	33.2%	7.8%	10.1%
ROE	21.3%	19.3%	21.2%	19.6%	18.7%
P/E (x)	32.1	27.2	20.4	18.9	17.2
P/BV (x)	6.3	4.4	3.7	3.2	2.8
EV/EBITDA (x)	15.6	12.1	8.5	7.4	6.4
Dividend Yield	1.0%	1.0%	1.5%	1.6%	1.7%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Shares O/S (mn)	1,175
Market Cap (HK\$ mn)	53,190
Market Cap (\$ mn)	6,856
Price (HK\$)	45.25
Date Of Price	20 Mar 15
Free Float(%)	
3M - Avg daily vol (mn)	4.70
3M - Avg daily val (HK\$ mn)	209.20
3M - Avg daily val (\$ mn)	27.0
HSCEI	1,2156.40
Exchange Rate	7.76
Price Target End Date	31-Dec-15
Price Target (HK\$)	40.00

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalyst for the stock price:</p> <ul style="list-style-type: none"> • Supportive policies on the railway sector to be announced in the coming 6-12 months • New order awarding for the rolling stock biddings • Potential asset injection after the completion of CSR-CNR merger 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> • Unexpected lift in railway equipment investment, particularly for locomotives • Better-than-expected new business development • Faster-than-expected ramp-up of ZZCSR's IGBT plant 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Unexpected changes in government's investment in railway development • Major fluctuations in raw material costs • Potential capacity constraints.
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Key financial metrics	FY13A	FY14E	FY15E	FY16E
Revenues (LC)	8,856	11,739	13,029	13,971
Revenue growth (%)	22%	33%	11%	7%
EBITDA (LC)	1,824	2,566	2,711	3,026
EBITDA margin (%)	21%	22%	21%	22%
Tax rate (%)	14%	17%	15%	15%
Net profit (LC)	1,467	2,086	2,249	2,476
EPS (LC)	1.33	1.77	1.91	2.11
EPS growth (%)	18%	33%	8%	10%
DPS (LC)	0.35	0.53	0.57	0.63
BVPS (LC)	8.32	9.86	11.36	13.02
Operating cash flow (LC mn)	726	1,301	2,567	3,127
Free cash flow (LC mn)	417	918	2,170	1,116
Interest cover (X)	NM	NM	NM	NM
Net margin (%)	16.6%	17.8%	17.3%	17.7%
Sales/assets (X)	0.77	0.81	0.79	0.75
Debt/equity (%)	0.9%	0.4%	0.2%	0.1%
Net debt/equity (%)	-33.2%	-31.5%	-40.7%	-39.7%
ROE (%)	19.3%	21.2%	19.6%	18.7%
Key model assumptions	FY13A	FY14E	FY15E	FY16E
Revenue growth (%)	22%	33%	11%	7%
Gross profit margin (%)	36%	38%	38%	37%

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
	FY15E	FY16E	FY15E	FY16E
Sensitivity to				
1ppt chg in revenue growth	1%	1%	1%	1%
1ppt chg in GPM	8%	8%	12%	11%

Source: J.P. Morgan estimates.

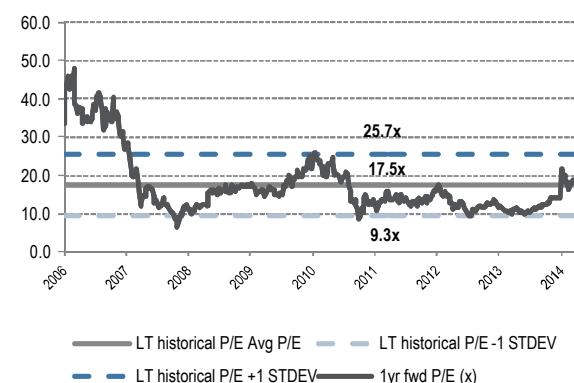
Comparative metrics	CMP LC	Mkt Cap \$Mn	P/E		EV/EBITDA		P/BV		YTD Stock perf.
			FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	
Zhuzhou CSR	45.25	6,858	18.9	17.2	15.3	13.7	3.2	2.8	0.0
CSR-H	9.91	30,727	13.0	12.3	8.2	7.4	1.5	1.4	-5.1
CNR-H	10.82	29,023	15.5	13.6	16.4	14.8	1.9	1.7	-2.7
Hollysys Automation	19.7	1,134	11.5	9.8	7.8	6.7	1.9	1.6	-17.8
Kawasaki Heavy Industry	625	8,711	19.1	15.4	11.1	9.3	2.6	2.3	13.0
Alstom	29.47	9,901	98.2	23.8	41.2	26.3	1.6	1.4	9.7

Source: Bloomberg, J.P. Morgan estimates. Prices are as of 3/20/2015

Valuation and price target basis

Our Dec-2015 PT of HK\$40.0 is derived based on the DCF valuation methodology. Our PT corresponds to a P/E of 16.4x/14.9x and a P/B of 2.8x/2.4x on FY15/FY16E.

ZZCSR—1yr forward P/E band chart



Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS	FY15E	FY16E
JPM old	1.91	2.11
JPM new	1.91	2.11
% chg	0%	0%
Consensus	1.98	2.25

Source: Bloomberg, J.P. Morgan estimates.

FY14 result review

Table 1: ZZCSR—FY14 results review

Rmb MMs	FY14A	FY13A	Y/Y chg%	FY14 JPMe	% Diff	2H14	2H13	Y/Y chg%	4Q14	4Q13	Y/Y chg%
Revenue	12,676	8,856	43%	11,739	8%	7,496	6,232	20%	3,855	4,022	-4%
Cost of sales	(7,876)	(5,695)		(7,278)		(4,553)	(4,067)		(2,552)	(2,686)	
Gross profit	4,800	3,161	52%	4,461	8%	2,943	2,165	36%	1,303	1,336	-2%
<i>GPM%</i>	<i>37.9%</i>	<i>35.7%</i>		<i>38.0%</i>		<i>39.3%</i>	<i>34.7%</i>		<i>33.8%</i>	<i>33.2%</i>	
Operating expenses	(2,479)	(1,587)	56%	(2,246)	10%	(1,513)	(1,045)	45%	(877)	(706)	24%
Business taxes	(100)	(75)		(94)		(70)	(54)		(38)	(44)	
Selling expenses	(881)	(498)		(684)		(606)	(367)		(387)	(270)	
Admin expenses	(1,349)	(1,005)		(1,233)		(855)	(639)		(477)	(415)	
Impairment loss of assets	(149)	(8)		(235)		18	15		25	23	
Other gains/losses (net)	339	89	280%	169	100%	220	79	177%	192	67	189%
Other investment income	70	0		80		30	0		13	0	
Non-operating income	272	90		90		191	80		181	67	
Non-operating expenses	(3)	(1)		(1)		(2)	(1)		(1)	(1)	
EBIT	2,660	1,664	60%	2,384	12%	1,650	1,199	38%	618	696	-11%
<i>EBIT margin%</i>	<i>21.0%</i>	<i>18.8%</i>		<i>20.3%</i>					<i>16.0%</i>	<i>17.3%</i>	
Net finance expenses	43	27		47		33	(0)		9	(5)	
Share of profit of associates & JCEs	52	13		70		20	17		(0)	12	
Earnings before taxes	2,755	1,704	62%	2,501	10%	1,703	1,216	40%	627	703	-11%
Income tax expenses	(363)	(237)		(413)		(166)	(143)		18	(80)	
Net profit	2,392	1,466	63%	2,089	15%	1,537	1,073	43%	644	624	3%
Minority interest	3	1		(3)		0	(6)		4	(6)	
Net profit attributable to shareholders	2,395	1,467	63%	2,086	15%	1,537	1,067	44%	648	618	5%
<i>Net margin</i>	<i>18.9%</i>	<i>16.6%</i>		<i>17.8%</i>					<i>16.8%</i>	<i>15.4%</i>	
Op-CF	2,057	726	183%	1,301	58%	1,888	1,369	38%			
Dividend	470	411									
Per share (Rmb/share)											
EPS (Rmb/share)	2.04	1.33		1.77		1.31	0.91		0.55	0.57	
DPS (Rmb/share)	0.40	0.35									
Margins											
GP margin	37.9%	35.7%		38.0%		39.3%	34.7%		33.8%	33.2%	
EBIT margin	21.0%	18.8%		20.3%		22.0%	19.2%		16.0%	17.3%	
EBITDA margin	0.0%	0.0%		0.0%		0.0%	0.0%		16.0%	17.3%	
Net margin	18.9%	16.6%		17.8%		20.5%	17.1%		16.8%	15.4%	
Expenses as % of revenue											
Business taxes	0.8%	0.9%		0.8%		0.9%	0.9%		1.0%	1.1%	
Selling expenses	6.9%	5.6%		5.8%		8.1%	5.9%		10.0%	6.7%	
Admin expenses	10.6%	11.3%		10.5%		11.4%	10.3%		12.4%	10.3%	
Impairment loss of assets	1.2%	0.1%		2.0%		-0.2%	-0.2%		-0.6%	-0.6%	
									22.7%	17.5%	
Other ratios											
Effective tax rate (%)	13.2%	13.9%		16.5%		9.7%	11.8%		-2.8%	11.3%	
MI as % of NP	-0.1%	-0.1%		0.1%		0.0%	0.6%		-0.6%	1.0%	
Op-CF/NPAT (x)	0.9x	0.5x		0.6x		1.2x	1.3x				

Source: Company data, J.P. Morgan estimates.

Table 2: ZZCSR—Revenue breakdown by segment

Rmb MMs	FY14A	FY13A	Y/Y chg%	FY14 JPMe	% Diff	2H14	2H13	Y/Y chg%	1H14	H/H chg%
Total revenue	12,676	8,856	43%	11,739	8%	7,496	6,232	20%	5,180	45%
Train-borne electrical system	11,394	7,851	45%	10,654	7%	6,606	5,634	17%	4,789	38%
Train power supply and control system	9,671	6,177	57%	8,784	10%	5,622	4,631	21%	4,049	39%
Locomotives	3,704	2,906	27%	4,069	-9%	2,989	2,096	43%	716	318%
EMUs	4,759	2,315	106%	3,473	37%	1,929	2,002	-4%	2,830	-32%
Metropolitan rail equipment	1,208	956	26%	1,242	-3%	704	534	32%	504	40%
Safety equipment	575	571	1%	657	-12%	365	348	5%	210	74%
Maintenance vehicles	1,149	1,103	4%	1,213	-5%	619	654	-5%	529	17%
Electric components	1,282	1,005	28%	1,086	18%	890	598	49%	392	127%
Power semiconductor components	430	523	-18%			261	312	-16%	169	55%
Sensors and related products	0	0				0	0		0	
Other products	852	482	77%			629	329	91%	223	182%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Zhuzhou CSR Times Electric Co., Ltd. (Overweight; Price Target: HK\$40.00)

Investment Thesis

We continue to like ZZCSR fundamentally for its possession of IP, capability of continued innovation, and proven track record of returns and cash generation.

We believe the IGBT business, although a short-term pain, could emerge as a meaningful growth engine once it takes off in the longer term, which we have not yet factored into our assumptions.

Valuation

Our Dec-15 PT of HK\$40 corresponds to a target P/E of 16x on FY15E, on par with our target multiple for CSR. Our PT is based on our DCF valuation, using the following assumptions:

WACC = 10.9%, driven by:

Cost of equity = 12.7% (Rf: 5.0%, Equity risk premium: 7.0%, Company beta: 1.1x);

Cost of debt = 3.8% (pre-tax cost of debt: 5.0%, tax rate: 25%);

Target gearing = 20%, terminal growth rate = 0%

Risks to Rating and Price Target

Key downside risks include: 1) an unexpected slowdown in the government's investment in railway development; 2) major fluctuations in raw material costs; 3) potential capacity constraints; and 4) larger-than-expected costs (including both operating and leasing expenses) associated with the IGBT operation.

Zhuzhou CSR Times Electric Co., Ltd.: Summary of Financials

Income Statement						Cash flow statement					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenues	7,249	8,856	11,739	13,029	13,971	EBIT	1,317	1,664	2,384	2,509	2,754
% change Y/Y	1.7%	22.2%	32.6%	11.0%	7.2%	Depr. & amortization	147	160	182	202	272
Gross Profit	2,446	3,161	4,461	4,886	5,169	Change in working capital	(54)	(900)	(1,066)	268	498
EBITDA	1,464	1,824	2,566	2,711	3,026	Other adjustment	(70)	(1)	99	(153)	(120)
% change Y/Y	(2.0%)	24.6%	40.7%	5.6%	11.6%	Taxes	(179)	(237)	(199)	(413)	(397)
EBITDA margin	20.2%	20.6%	21.9%	20.8%	21.7%	Cash flow from operations	1,247	726	1,301	2,567	3,127
EBIT	1,317	1,664	2,384	2,509	2,754	Capex	(403)	(298)	(343)	(343)	(1,943)
% change Y/Y	(3.0%)	26.3%	43.3%	5.2%	9.8%	Disposal/(purchase)	21	5	0	0	0
EBIT Margin	18.2%	18.8%	20.3%	19.3%	19.7%	Other adjustments	398	(1,034)	50	64	81
Net Interest	(5)	18	47	63	80	Cash flow from investing	16	(1,327)	(294)	(279)	(1,862)
Earnings before tax	1,404	1,704	2,501	2,649	2,917	Free cash flow	869	417	918	2,170	1,116
% change Y/Y	1.7%	21.4%	46.8%	5.9%	10.1%	Equity raised/(repaid)	10	1,776	0	0	0
Tax	(179)	(237)	(413)	(397)	(438)	Debt raised/(repaid)	(632)	29	(265)	(7)	(17)
as % of EBT	12.7%	13.9%	16.5%	15.0%	15.0%	Other adjustments	0	0	(2)	(2)	(1)
Net income	1,224	1,467	2,086	2,249	2,476	Dividends paid	(397)	(382)	(411)	(626)	(675)
% change Y/Y	3.3%	19.9%	42.2%	7.8%	10.1%	Cash flow from financing	(1,019)	1,422	(679)	(635)	(693)
Shares outstanding	1,084	1,175	1,175	1,175	1,175	Net changes in cash	237	816	328	1,653	571
EPS	1.13	1.33	1.77	1.91	2.11	Beginning cash	2,054	2,291	3,107	3,435	5,087
% change Y/Y	3.3%	18.1%	33.2%	7.8%	10.1%	Ending cash	2,319	3,136	3,464	5,117	5,688
						DPS	0.35	0.35	0.53	0.57	0.63
Balance sheet						Ratio Analysis					
Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Cash and cash equivalents	2,319	3,136	3,464	5,117	5,688	Gross margin	33.7%	35.7%	38.0%	37.5%	37.0%
Accounts receivable	3,628	4,907	5,789	5,711	5,359	EBITDA margin	20.2%	20.6%	21.9%	20.8%	21.7%
Inventories	1,110	1,428	1,994	2,231	2,411	Operating margin	18.2%	18.8%	20.3%	19.3%	19.7%
Others	147	1,341	1,392	1,415	1,431	Net profit margin	16.9%	16.6%	17.8%	17.3%	17.7%
Current assets	7,203	10,813	12,639	14,474	14,890	EBITDA / Interest Paid (x)	91.8	654.8	1,030.7	1,655.3	2,471.7
Other long-term assets	225	276	276	276	276	Net debt to total capital	(55.3%)	(49.8%)	(46.0%)	(68.7%)	(65.8%)
Net fixed assets	1,703	1,830	1,974	2,099	3,755	Net debt to equity	(35.6%)	(33.2%)	(31.5%)	(40.7%)	(39.7%)
Total Assets	9,657	13,398	15,457	17,510	19,680	Sales/assets	0.8	0.8	0.8	0.8	0.8
						Assets/equity	1.6	1.5	1.5	1.4	1.4
Liabilities						ROE	21.3%	19.3%	21.2%	19.6%	18.7%
Short-term loans	0	31	0	0	0	ROA	13.4%	12.7%	14.5%	13.6%	13.3%
Trade Payables	1,987	2,679	2,991	3,346	3,617	Accounts receivable turnover	2.5	2.1	2.2	2.3	2.5
Others	1,046	1,111	1,218	1,307	1,415	Accounts payable turnover	2.9	2.4	2.6	2.6	2.5
Total current liabilities	3,033	3,821	4,209	4,653	5,032	Inventory turnover	3.5	4.5	4.3	3.9	3.8
Long-term debt	28	52	45	28	15	Asset Turnover	0.8	0.8	0.8	0.8	0.8
Other liabilities	277	376	376	376	376	Net WC to sales ratio	0.6	0.8	0.7	0.8	0.7
Total Liabilities	3,339	4,248	4,629	5,057	5,423						
Minority interests	135	134	137	139	142						
Shareholders' equity	6,184	9,016	10,691	12,314	14,116						
BVPS	5.70	8.32	9.86	11.36	13.02						

Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile

Zhuzhou CSR Times Electric Co., Ltd. Class H (CHINA / Industrials)
 As Of: 13-Mar-2015

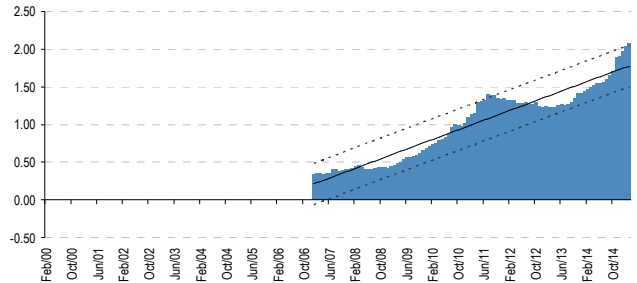
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

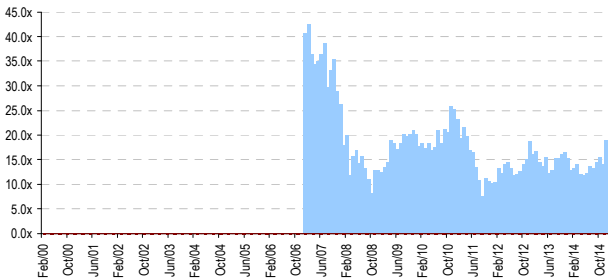
Local Share Price **Current: 43.80**



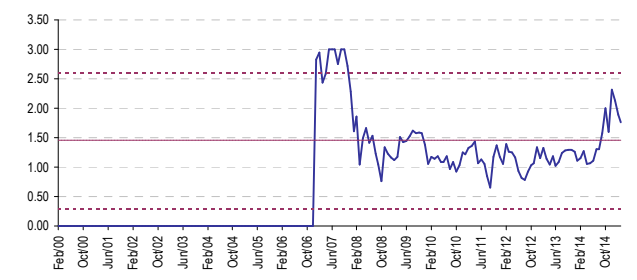
12 Mth Forward EPS **Current: 2.08**



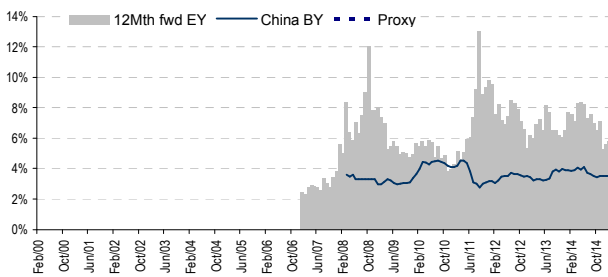
PE (1Yr Forward) **Current: 17.0x**



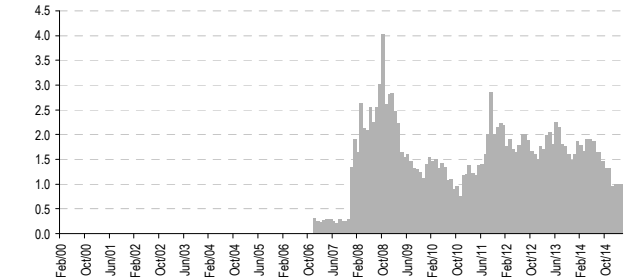
P/E Relative to China Index **Current: 1.76**



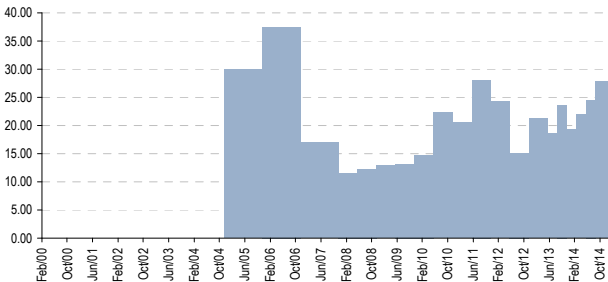
Earnings Yield (& Local Bond Yield) **Current: 6%**



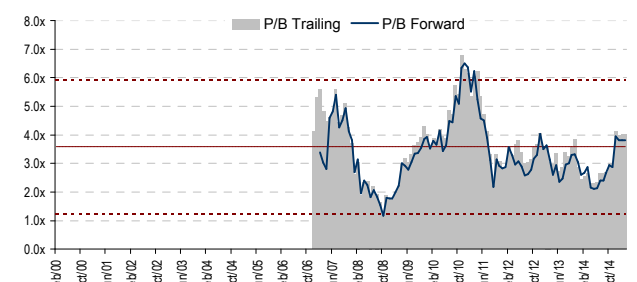
Dividend Yield (Trailing) **Current: 0.99**



ROE (Trailing) **Current: 27.85**



Price/Book (Value) **Current: 4.0x**



Summary

Zhuzhou CSR Times Electric Co., Ltd. Cl:		As Of: 13-Mar-15	
CHINA		Local Price: 43.80	
Industrials		EPS: 2.08	
	TICKER 3898 HK		
	Latest	Min	Max
12mth Forward PE	17.01x		
P/BV (Trailing)	4.02	1.23	6.78
Dividend Yield (Trailing)	0.99x	0.22	4.02
ROE (Trailing)	27.85	11.57	37.52
		Median	Average
		3.52	3.58
		1.61	1.56
		21.28	21.85
			2 S.D.+
			5.93
			2 S.D. -
			1.24
			0.16
			6.43
		% to Min	% to Max
		-69%	69%
		-78%	306%
		-58%	35%
		% to Med	% to Avg
		-12%	-11%
		62%	58%
		-24%	-22%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

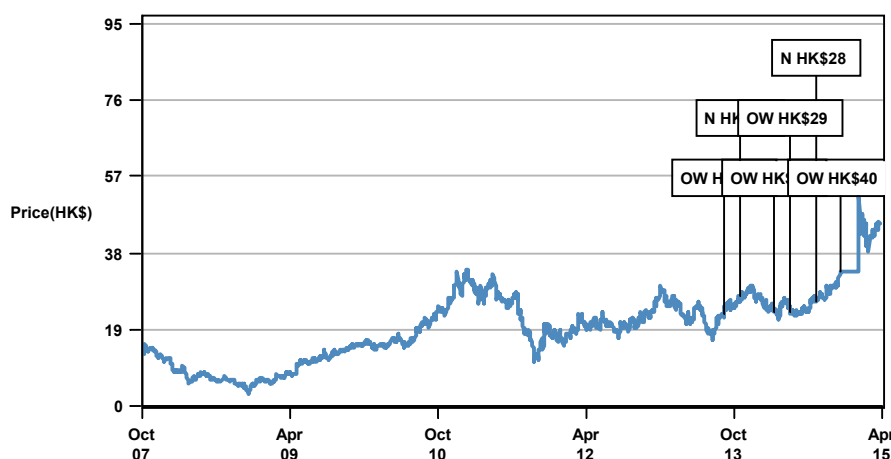
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Zhuzhou CSR Times Electric Co., Ltd. (3898.HK, 3898 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
22-Aug-13	OW	23.00	28.00
21-Oct-13	N	27.40	28.00
27-Feb-14	OW	23.20	30.00
27-Apr-14	OW	23.60	29.00
02-Aug-14	N	26.05	28.00
28-Oct-14	OW	33.35	40.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Aug 22, 2013.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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IB clients*	56%	49%	33%
JPMS Equity Research Coverage	45%	48%	7%
IB clients*	75%	67%	52%

*Percentage of investment banking clients in each rating category.

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