

## Zhuzhou CSR Times Electric

# Outlook positive all around

### We attended Zhuzhou's 23 March analyst briefing and came away feeling even more positive about Zhuzhou's prospects. Highlights from management's comments:

1) Zhuzhou has already started working with CNR subsidiaries on converters and is confident regarding CNR order inflow even without acquiring CNR assets thanks to Zhuzhou's superior product quality. 2) Solid progress at Insulated Gate Bipolar Transistor (IGBT): Zhuzhou's IGBT business will post a narrower loss this year and likely break even in 2016. 3) ASP for safety equipment could double or triple as products are updated. 4) We expect MU converter revenue to increase 20%, as implied by China Railway Corporation's (CRC) equipment tender plan, and locomotive converters to remain flat with 2014. 5) The company achieved approximately Rmb0.9-1bn in overseas revenue in 2014 (7-8% revenue) and expects the amount to double this year; in addition, Zhuzhou's gross margin is slightly higher overseas than the domestic market. We raise our EPS forecasts by 13-15% for 2015/16 following the strong 2014 EPS beat and optimistic comments from management regarding 2015's outlook. Our new PT is HK\$66/sh based on 15x 2015E EPS, to which we add 50% EPS accretion from becoming a CNR supplier.

**Cooperation with CNR under way:** Management commented that post the CNR/CSR merger announcement, some CNR subsidiaries already approached Zhuzhou for converter supply as Zhuzhou's product quality is better than its CNR counterparts'. Management indicated there could be small deliveries to CNR in 2015, but this would increase in 2016. Zhuzhou's existing production capacity does not seem to conflict with CNR orders, which means EPS accretion could be higher than our estimated 50% as we had assumed some equity issuance would be required to purchase CNR's related assets.

**Solid progress with IGBT:** Management commented that production yield for IGBT modules have reached 90%, and Zhuzhou will be ready to deliver 30-50K units in 2015 (production capacity is 500K units). Management expects the operating loss to narrow in 2015 versus Rmb250mn in 2014 and potentially to break even in 2016.

**L-T revenue supported by maintenance:** Management indicated that maintenance revenue accounted for less than 10% of MU converter revenue since most MUs are sold post 2008 and the replacement cycle is 8 to 10 years. We expect maintenance to account for a higher percentage of revenue long term when new train sales slow down.

### 3898.HK: Financial and Valuation Metrics EPS CNY

FY Dec	2013	2014	2015	2016	2017
EPS	1.35A	2.04A	2.36E	2.57E	2.87E
Previous EPS	1.35A	1.83E	2.05E	2.28E	N/A
Consensus EPS	1.33A	1.81E	2.01E	2.27E	N/A
P/E	28.3	18.8	16.2	14.9	13.3

Source: Barclays Research. Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 5.

Stock Rating **OVERWEIGHT**  
Unchanged

Industry View **NEUTRAL**  
Unchanged

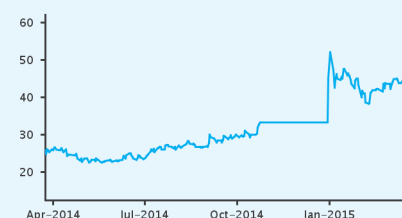
Price Target **HKD 66.00**  
raised 6% from HKD 62.00

Price (23-Mar-2015) HKD 47.80  
Potential +38%  
Upside/Downside  
Tickers 3898 HK / 3898.HK

Market Cap (USD mn) 7243  
Shares Outstanding (mn) 1175.48  
Free Float (%) 100.00  
52 Wk Avg Daily Volume (mn) 3.0  
52 Wk Avg Daily Value (USD mn) 0.00  
Dividend Yield (%) 1.0  
Return on Equity TTM (%) 27.85  
Current BVPS (CNY) 8.80

Source: Thomson Reuters

Price Performance Exchange-HKG  
52 Week range HKD 54.35-22.30



[Link to Barclays Live for interactive charting](#)

### Asia ex-Japan Capital Goods

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Asia ex-Japan Capital Goods Industry View: NEUTRAL

## Zhuzhou CSR Times Electric (3898.HK)

Stock Rating: OVERWEIGHT

Income statement (CNYmn)	2014A	2015E	2016E	2017E	CAGR
Revenue	12,676	14,593	15,042	16,109	8.3%
EBITDA	2,516	3,083	3,453	3,865	15.4%
EBIT	2,321	2,806	3,089	3,469	14.3%
Pre-tax income	2,755	3,221	3,526	3,969	12.9%
Net income	2,395	2,774	3,018	3,378	12.1%
EPS (reported) (CNY)	2.04	2.36	2.57	2.87	12.1%
Diluted shares (mn)	1,175	1,175	1,175	1,175	0.0%
DPS (CNY)	0.40	0.46	0.50	0.56	12.1%

Price (23-Mar-2015) HKD 47.80  
 Price Target HKD 66.00

**Why Overweight?** We see Zhuzhou CSR as the biggest beneficiary of the merger, as it would gain from the removal of the "man-made" barrier for CNR to source components from Zhuzhou and it has the first right to purchase competing subsidiaries of CNR and become a CNR supplier. We are positive on the company given the large demand potential.

Margin and return data	Average				
EBITDA margin (%)	19.8	21.1	23.0	24.0	22.0
EBIT margin (%)	18.3	19.2	20.5	21.5	19.9
Pre-tax margin (%)	21.7	22.1	23.4	N/A	22.4
Net margin (%)	18.9	19.0	20.1	21.0	19.7
ROIC (%)	27.6	26.7	28.3	32.4	28.8
ROA (%)	15.8	14.7	13.5	13.2	14.3
ROE (%)	23.9	22.4	20.1	19.2	21.4

**Upside case** HKD 74.80

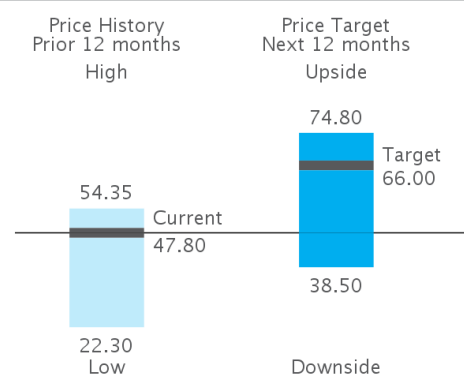
Our upside case assumes the purchase of competing subsidiaries of CNR, creating 70% EPS accretion.

**Downside case** HKD 38.50

Our downside case assumes Zhuzhou CSR does not purchase the competing business of CNR and therefore 0% EPS accretion, and applies a 14x multiple on 2015E EPS.

Balance sheet and cash flow (CNYmn)	CAGR				
Tangible fixed assets	1,883	3,497	3,659	3,789	26.2%
Intangible fixed assets	297	271	245	218	-9.8%
Cash and equivalents	2,680	4,467	7,330	10,173	56.0%
Total assets	16,925	20,762	23,900	27,465	17.5%
Short and long-term debt	42	42	42	42	0.0%
Net debt/(funds)	-2,638	-4,425	-7,288	-10,131	N/A
Other long-term liabilities	730	1,067	1,404	1,741	33.6%
Total liabilities	5,754	6,821	7,488	8,273	12.9%
Shareholders' equity	10,991	13,765	16,238	19,024	20.1%
Change in working capital	-2,617	319	246	-118	N/A
Cash flow from operations	-192	3,264	3,510	3,498	N/A
Capital expenditure	-261	-2,000	-500	-500	N/A
Free cash flow	-453	1,264	3,010	2,998	N/A

## Upside/Downside scenarios



Valuation and leverage metrics	Average				
P/E (reported) (x)	18.8	16.2	14.9	13.3	15.8
EV/EBITDA (x)	15.5	12.1	9.9	8.1	11.4
Equity FCF yield (%)	-0.6	-1.7	-0.3	-0.3	-0.7
EV/sales (x)	3.1	2.5	2.3	2.0	2.5
P/BV (x)	4.1	3.3	2.8	N/A	3.4
Dividend yield (%)	1.0	1.2	1.3	1.5	1.3
Total debt/capital (%)	0.2	0.2	0.2	0.2	0.2
Net debt/EBITDA (x)	-5.6	-5.3	-4.8	-4.5	-5.0

## Selected operating metrics (CNYmn)

Locomotives	3,704	3,704	3,519	3,871
Electric multiple units	4,759	5,723	5,745	5,745
Metropolitan rail transportation equipment	1,208	1,328	1,461	1,607
Train operation safety equipment revenue	575	1,149	1,322	1,520
Rail maintenance vehicle related revenue	1,149	1,206	1,266	1,330
Power semiconductor components revenue	430	430	430	430
Sensors and related products revenue	135	155	178	205
Other products revenue	717	896	1,120	1,400

Source: Company data, Barclays Research  
 Note: FY End Dec

## Valuation and key risks

Our 12-month price target of HK\$66.00 for Zhuzhou CSR is based on our target P/E of 16x applied to our EPS for 2015, to which we add 50% EPS accretion from becoming a CNR supplier. We retain our Overweight rating.

The key risks to our price target for Zhuzhou CSR, in our view, are the following: 1) any delay in the process of CSR/CNR merger; 2) if Zhuzhou CSR did not execute its right to buy the competing business; 3) higher-than expected cost in purchasing competing business and 4) lower-than-expected EPS accretion after asset acquisition.

FIGURE 1  
Zhuzhou CSR FY14 revenue breakdown – actual vs forecast

Revenue breakdown	2014A	2014E	A vs E	2013A	Y/Y
Train power converters, auxiliary power etc	9,671	8,768	10%	6,177	57%
... Locomotives	3,704	3,294	12%	2,906	27%
... Electric Multiple units	4,759	4,327	10%	2,315	106%
... Metropolitan rail transportation equipment	1,208	1,147	5%	956	26%
Train operation safety equipment	575	571	1%	571	1%
Railway maintenance vehicles related products	1,149	1,268	-9%	1,103	4%
<b>Train-borne electrical systems</b>	<b>11,394</b>	<b>10,607</b>	<b>7%</b>	<b>7,851</b>	<b>45%</b>
Power semiconductor components	430	471	-9%	523	-18%
Sensors and related products	135	135	0%	117	15%
Other products	717	401	79%	365	96%
<b>Electric components</b>	<b>1,282</b>	<b>1,007</b>	<b>27%</b>	<b>1,005</b>	<b>28%</b>
<b>Total revenue</b>	<b>12,676</b>	<b>11,614</b>	<b>9%</b>	<b>8,856</b>	<b>43%</b>

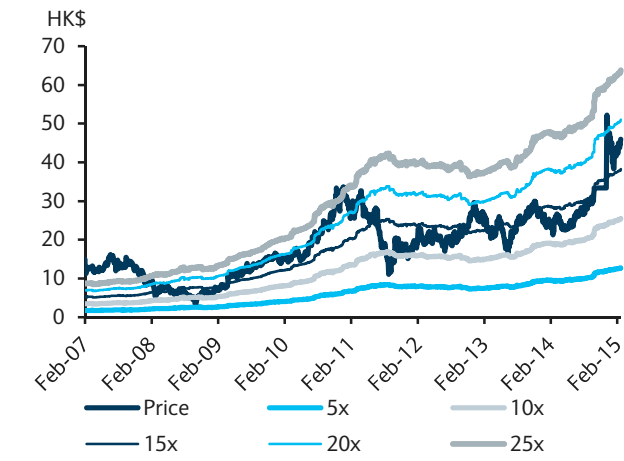
Source: Company data, Barclays Research estimates

FIGURE 2  
Zhuzhou CSR FY14 results breakdown – actual vs estimates

RMB mn	FY14A	2014E	A vs E	FY13	YoY%	4Q14	4Q14E	A vs E
<b>Sales</b>	12,676	11,535	9.9%	8,856	43.1%	3,855	2,714	42.0%
COGS	-7,976	-7,133	11.8%	-5,770	38.2%	-2,590	-1,748	48.2%
<b>Gross profit</b>	4,700	4,402	6.8%	3,086	52.3%	1,265	967	30.8%
Selling expense	-881	-648	35.9%	-498	76.7%	-387	-154	151.2%
G&A expense	-1,349	-1,180	14.4%	-1,005	34.2%	-477	-307	55.2%
Other expense	-149	-250	-40.5%	-8	1725.7%	25	-76	-132.6%
<b>Operating profit</b>	2,321	2,324	-0.1%	1,574	47.4%	426	429	-0.8%
Investment income	122	113	7.4%	13	n.m.	13	4	198.0%
Net interest expense	43	48	-9.9%	27	56.5%	9	13	-35.3%
Non-operating income	269	116	131.7%	89	201.8%	179	26	578.4%
PBT	2,755	2,602	5.9%	1,704	61.7%	627	473	32.4%
Income tax	-363	-454	-20.0%	-237	52.9%	18	-73	-124.1%
Net profit	2,392	2,148	11.4%	1,466	63.1%	644	400	60.9%
Minorities	-3	1	-340.9%	-1	253.0%	-4	0	
<b>Net profit attributable</b>	2,395	2,147	11.5%	1,467	63.2%	648	400	61.9%
EPS	2.04	1.83	11.5%	1.35	50.6%	0.55	0.34	61.9%
<b>Key metrics</b>								
Gross margin	37.1%	38.2%	-1.1%	34.8%	2.2%	32.8%	35.6%	-2.8%
SG&A	17.6%	15.8%	1.7%	17.0%	0.6%	22.4%	17.0%	5.4%
Operating margin	18.3%	20.2%	-1.8%	17.8%	0.5%	11.0%	15.8%	-4.8%
Net margin	18.9%	18.6%	0.2%	16.6%	2.3%	16.7%	-2.7%	19.4%

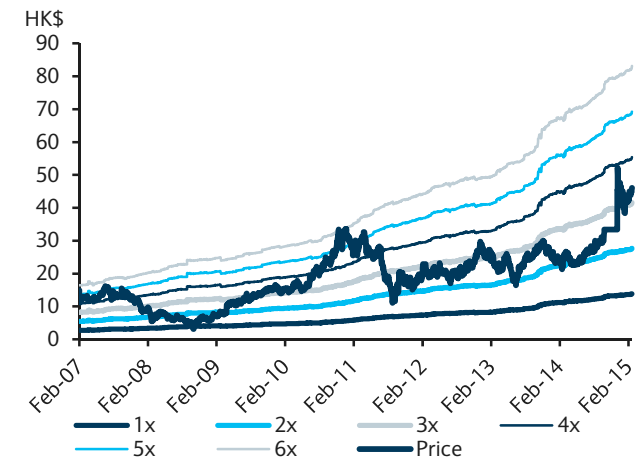
Source: Company data, Barclays Research estimates

FIGURE 3  
Zhuzhou CSR P/E band chart



Source: Bloomberg, Barclays Research

FIGURE 4  
Zhuzhou CSR P/B band chart



Source: Bloomberg, Barclays Research

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### Primary Stocks (Ticker, Date, Price)

Zhuzhou CSR Times Electric (3898.HK, 23-Mar-2015, HKD 47.80), Overweight/Neutral, J

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Sinotruk (Hong Kong) Limited. (3808.HK)	Sunspring Metal (2062.TW)	Thermax Ltd. (THMX.NS)
Voltas Ltd. (VOLT.NS)	Weichai Power Co., Ltd. (2338.HK)	Zhuzhou CSR Times Electric (3898.HK)
Zoomlion Heavy Industry (1157.HK)		

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IMPORTANT DISCLOSURES CONTINUED

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**HKD 47.80 (23-Mar-2015)**

Stock Rating

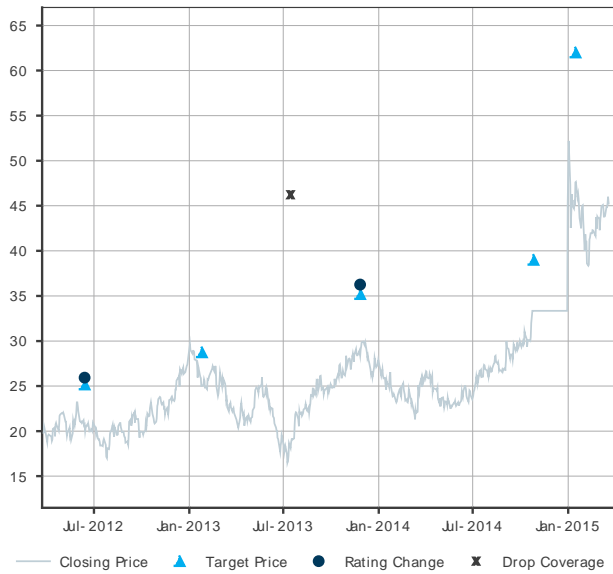
**OVERWEIGHT**

Industry View

**NEUTRAL**

**Rating and Price Target Chart - HKD (as of 23-Mar-2015)**

Currency=HKD



Date	Closing Price	Rating	Adjusted Price Target
15-Jan-2015	47.60		62.00
26-Oct-2014	33.35		39.00
26-Nov-2013	28.40	Overweight	35.20
09-Jul-2013	16.50	Drop Coverage	
25-Jan-2013	25.00		28.74
13-Jun-2012	20.75	Overweight	25.18

Source: Thomson Reuters, Barclays Research

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Source: IDC, Barclays Research

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**Valuation Methodology:** Our 12-month price target of HK\$66.00 for Zhuzhou CSR is based on our target P/E of 16x applied to our EPS for 2015 and assuming a merger EPS accretion of 50%. We see Zhuzhou CSR as the biggest beneficiary of the CSR/CNR merger, as it has the first right to purchase competing subsidiaries of CNR and become a CNR supplier. We estimate Zhuzhou could enjoy 50% EPS accretion after the acquisition of the competing subsidiaries of CNR.

**Risks which May Impede the Achievement of the Barclays Research Price Target:** The key risks to our price target, in our view, are the following: 1) Any delay in the process of CSR/CNR merger; 2) if Zhuzhou CSR did not execute its right to buy the competing assets; 3) higher-than-expected cost in purchasing the competing assets; and 4) lower-than-expected EPS accretion after asset acquisition.



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