

CIMC ENRIC HOLDINGS LTD

Demand outlook lifted but recovery is likely slow; maintain Neutral, lowering PT to HK\$7.7

CIMC-Enric rebounded YTD after a big drop last year (underperforming the HSCEI index by c60% in 2014) on improving demand outlook for gas equipment underpinned by the recent gas price cut by NDRC as well as expectations for more frequent pricing adjustments going forward. Stay Neutral as demand recovery is likely slow given diesel-to-gas conversion remains uneconomical.

- We reduce FY15/16E by 3~4% factoring in the result and latest guidance.** We trim our Dec-15 DCF-based PT by 14% to HK\$7.7, driven by earnings revisions as well as higher capex. ENRIC trades at 10x P/E and 1.5x P/B on FY16E, which appears fair against the 7% EPS CAGR and c16% ROE that we project over FY15-16E. Maintain Neutral. We would be buyers on dips at levels below HK\$6.0 (which corresponds to an 8x P/E).
- Core energy equipment segment—We model in sales recovery (+11%) and mild margin erosion, driven by EPC projects.** We expect the rebound in revenue to be driven by (1) EPC projects (mostly for constructing LNG terminals for ENN Energy and Shenzhen Gas); and (2) LNG vessel application & products (a new business recently started, to add cRmb0.5B in sales this year). We project small erosion in profitability (GPM to drop by 30bps in 2015) on rising contribution from lower-margin EPC projects. On the other hand, we expect flat sales for gas equipment as diesel-to-gas conversion remains uneconomical. We expect the segment to form c50% of profit.
- Chemical equipment segment—ASP and profitability to recover as Enric shifts focus to special tank.** We expect the segment to form c25% of profit.
- Liquid food equipment segment—Ziemann continues to drive the growth:** Sales surged by 44% last year, ahead of guidance (+30%), and we expect sales growth to remain robust this year (+20%), supported by solid backlog (including the mega project in Mexico). Euro depreciation remains a risk for German-based Ziemann. We expect the segment to form c25% of profit.
- Capex & payout:** We raise capex assumptions, in light of the investment need for new businesses—LNG vessel application & products. Management said it continues to look out for M&A opportunities, capex for which we have not modeled in. ENRIC intends to keep payout at 30%.

Neutral

3899.HK, 3899 HK

Price: HK\$6.90

▼ **Price Target: HK\$7.70**
Previous: HK\$9.00

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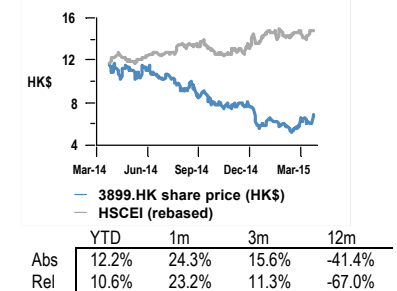
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Price Performance



CIMC ENRIC HOLDINGS LTD (Reuters: 3899.HK, Bloomberg: 3899 HK)

Rmb in mn, year-end Dec	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue (Rmb mn)	10,172	11,198	12,429	13,408	14,448
Net Profit (Rmb mn)	980	1,025	1,052	1,174	1,280
EPS (Rmb)	0.51	0.53	0.54	0.61	0.66
DPS (Rmb)	0.09	0.16	0.16	0.18	0.20
Revenue growth (%)	25.8%	10.1%	11.0%	7.9%	7.8%
EPS growth (%)	25.6%	4.1%	2.7%	11.6%	9.0%
ROCE	19.5%	17.4%	16.1%	16.2%	15.7%
ROE	21.0%	18.0%	16.3%	16.2%	15.7%
P/E (x)	10.9	10.4	10.2	9.1	8.3
P/BV (x)	2.1	1.8	1.6	1.4	1.2
EV/EBITDA (x)	8.6	8.3	7.6	6.7	5.9
Dividend Yield	1.7%	2.8%	3.0%	3.3%	3.6%

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

Company Data

Shares O/S (mn)	1,931
Market Cap (Rmb mn)	10,678
Market Cap (\$ mn)	1,718
Price (HK\$)	6.90
Date Of Price	24 Mar 15
Free Float(%)	-
3M - Avg daily vol (mn)	4.44
3M - Avg daily val (HK\$ mn)	27.04
3M - Avg daily val (\$ mn)	3.5
HSCEI	1,2177.82
Exchange Rate	7.76
Price Target End Date	31-Dec-15

See page 5 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"> • Acceleration in LNG applications • Recovery in liquid food and chemical tank container demand in developed market • Further cut in natural gas price • Value-accretive M&As 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> • Faster-than-expected resumption of delayed CNG/LNG projects in China • Faster-than-expected overseas expansion • Faster-than-expected expansion into new applications including LNG vessels 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Slower-than-expected natural gas infrastructure build-out in China • A sharp slowdown in global economy growth • Pricing pressure from Intensified competition
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Key financial metrics	FY13A	FY14A	FY15E	FY16E
Revenues (LC)	10,172	11,198	12,429	13,408
Revenue growth (%)	26%	10%	11%	8%
EBITDA (LC)	1,406	1,401	1,494	1,663
EBITDA margin (%)	14%	13%	12%	12%
Tax rate (%)	17%	12%	17%	17%
Net profit (LC)	980	1,025	1,052	1,174
EPS (LC)	0.51	0.53	0.54	0.61
EPS growth (%)	26%	4%	3%	12%
DPS (LC)	0.09	0.16	0.16	0.18
BVPS (LC)	2.69	3.08	3.53	3.98
Operating cash flow (LC mn)	1,137	1,089	966	1,075
Free cash flow (LC mn)	902	920	459	521
Interest cover (X)	68.9	79.8	NM	NM
Net margin (%)	9.6%	9.2%	8.5%	8.8%
Sales/assets (X)	1.12	1.07	1.12	1.10
Debt/equity (%)	10%	3%	0%	0%
Net debt/equity (%)	-19%	-24%	-24%	-24%
ROE (%)	21.0%	18.0%	16.3%	16.2%

Key model assumptions	FY13A	FY14E	FY15E	FY16E
Revenue growth (%)	25.8%	10.1%	11.0%	7.9%
Gross profit margin (%)	20.4%	18.8%	18.5%	18.7%

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	5%	5%	5%	5%

Source: J.P. Morgan estimates.

Comparative metrics

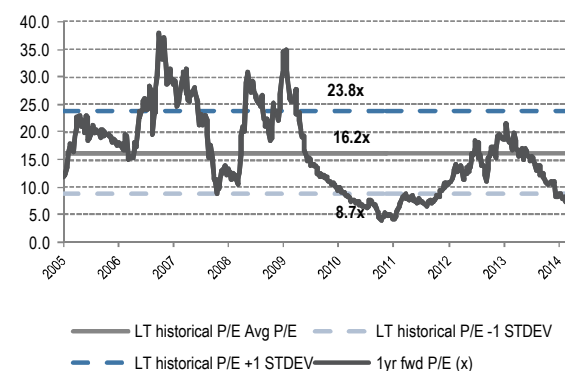
	CMP LC	Mkt Cap \$Mn	P/E		EV/EBITDA		P/BV		YTD Stock perf.
			FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	
CIMC Enric	6.9	1,719	10.1	9.1	6.3	5.7	1.6	1.4	12.2
Furui*	61.0	1,329	28.5	21.8	NA	NA	5.6	4.7	25.0
Chart Industries*	34.2	1,044	19.3	15.2	8.0	7.2	1.1	1.1	0.0
Dongfang Electric	14.7	7,601	12.5	11.7	9.4	8.8	1.1	1.0	2.8
Shanghai Electric	4.5	19,734	17.1	17.1	16.7	16.1	1.2	1.1	8.7
Xinjiang Goldwind	12.3	6,421	13.5	14.5	14.3	14.5	1.6	1.5	2.3

Source: Bloomberg, *Bloomberg consensus for stocks Not Covered, J.P. Morgan estimates. Prices are as of 3/24/2015

Valuation and price target basis

Our Dec-15 PT of HK\$7.7 is derived based on DCF valuation methodology. Our PT corresponds to a P/E of 11.3x/10.1x and a P/B of 1.7x/1.5x on FY15/FY16E.

CIMC Enric--1yr forward P/E band chart



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

JPM vs. consensus, change in estimates

NPAT (Rmb MM\$)	FY15E	FY16E
JPMe old	1,086	1,222
JPMe new	1,052	1,174
% chg	-3%	-4%
Consensus	1,059	1,198

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

CIMC ENRIC HOLDINGS LTD *(Neutral; Price Target: HK\$7.70)*

Investment Thesis

While we believe the long-term capex outlook for China's natural gas infrastructure remains intact despite the temporary pause in 2014, the near-term outlook remains challenging as diesel-to-gas-conversion looks uneconomical in light of the sharp drop in diesel prices (down >30% since 2H14) against marginally lowered gas prices (down by 4-5% only).

CIMC-Enric rebounded YTD after a big drop last year (underperforming the HSCEI index by c60% in 2014), on improving demand outlook for gas equipment underpinned by the recent gas price cut by NDRC as well as expectations for more frequent pricing adjustments going forward. Current counters appears fair against the 7% EPS CAGR and c16% ROE. Maintain Neutral. We would be buyers on dips at levels below HK\$6.0 (which corresponds to an 8x P/E).

Valuation

Our Dec-15 PT of HK\$7.7 is derived based on DCF valuation methodology. Our DCF valuation uses the following assumptions: a WACC of 12.0%, driven by a cost of equity of 12.0% (risk-free rate of 5%, equity risk premium of 7% and company beta of 1.0x), a cost of debt of 5.3%, a target debt to capital of 0% and terminal growth of 0%. Our PT corresponds to a P/E of 11.3x/10.1x and a P/B of 1.7x/1.5x on FY15/FY16E.

Risks to Rating and Price Target

Upside risks to our rating and price target include: 1) faster-than-expected resumption of delayed CNG/LNG projects in China; 2) faster-than-expected overseas expansion; 3) faster-than-expected expansion into new applications including LNG vessels; and 4) favourable policy support from the government to speed up gas infrastructure build-out in China.

Downside risks include: 1) slower-than-expected natural gas infrastructure build-out in China; 2) a sharp slowdown in global economic growth; and 3) pricing pressure from intensified competition.

CIMC ENRIC HOLDINGS LTD: Summary of Financials

Income Statement						Cash flow statement					
Rmb in millions, year end Dec	FY14	FY15E	FY16E	FY17E	FY18E	Rmb in millions, year end Dec	FY14	FY15E	FY16E	FY17E	FY18E
Revenues	11,198	12,429	13,408	14,448	15,447	EBIT	1,201	1,272	1,413	1,539	1,647
% change Y/Y	10.1%	11.0%	7.9%	7.8%	6.9%	Depr. & amortization	200	222	249	278	307
EBITDA	1,401	1,494	1,663	1,818	1,955	Change in working capital	(165)	(309)	(345)	(217)	(206)
% change Y/Y	(0.4%)	6.7%	11.3%	9.3%	7.5%	Taxes	(147)	(218)	(243)	(265)	(284)
EBIT	1,201	1,272	1,413	1,539	1,647	Cash flow from operations	1,089	966	1,075	1,336	1,464
% change Y/Y	(1.2%)	5.9%	11.1%	8.9%	7.0%	Capex	(429)	(500)	(540)	(540)	(540)
EBIT Margin	10.7%	10.2%	10.5%	10.7%	10.7%	Disposal/(purchase)	245	0	0	0	0
Net Interest	(18)	10	17	21	26	Net Interest	(18)	10	17	21	26
Earnings before tax	1,183	1,282	1,431	1,560	1,673	Other	16	17	18	21	27
% change Y/Y	(1.0%)	8.3%	11.6%	9.0%	7.3%	Free cash flow	920	459	521	779	903
Tax	(147)	(218)	(243)	(265)	(284)	Equity raised/(repaid)	0	0	0	0	0
as % of EBT	12.4%	17.0%	17.0%	17.0%	17.0%	Debt raised/(repaid)	(361)	(185)	(1)	(0)	(3)
Net income (reported)	1,025	1,052	1,174	1,280	1,373	Other	(33)	(7)	(1)	(1)	(1)
% change Y/Y	4.6%	2.6%	11.6%	9.0%	7.3%	Dividends paid	(178)	(299)	(316)	(352)	(384)
Shares outstanding	1,934	1,931	1,931	1,931	1,931	Beginning cash	1,541	1,678	1,669	1,905	2,369
EPS (reported)	0.53	0.54	0.61	0.66	0.71	Ending cash	1,678	1,669	1,905	2,369	2,933
% change Y/Y	4.1%	2.7%	11.6%	9.0%	7.3%	DPS	0.16	0.16	0.18	0.20	0.21
Balance sheet						Ratio Analysis					
Rmb in millions, year end Dec	FY14	FY15E	FY16E	FY17E	FY18E	Rmb in millions, year end Dec	FY14	FY15E	FY16E	FY17E	FY18E
Cash and cash equivalents	1,678	1,669	1,905	2,369	2,933	EBITDA margin	12.5%	12.0%	12.4%	12.6%	12.7%
Accounts receivable	3,689	4,094	4,417	4,759	5,088	Operating margin	10.7%	10.2%	10.5%	10.7%	10.7%
Inventories	1,955	2,259	2,581	2,777	2,968	Net margin	9.2%	8.5%	8.8%	8.9%	8.9%
Others	280	309	333	357	381	Sales per share growth	9.5%	11.1%	7.9%	7.8%	6.9%
Current assets	7,601	8,333	9,235	10,263	11,371	Sales growth	10.1%	11.0%	7.9%	7.8%	6.9%
LT investments	-	-	-	-	-	Net profit growth	4.6%	2.6%	11.6%	9.0%	7.3%
Net fixed assets	2,232	2,497	2,773	3,021	3,238	EPS growth	4.1%	2.7%	11.6%	9.0%	7.3%
Total Assets	10,601	11,611	12,804	14,094	15,434	Interest coverage (x)	79.8	NM	NM	NM	NM
Liabilities						Net debt to equity	(24.2%)	(24.1%)	(24.4%)	(27.1%)	(30.2%)
Short-term loans	170	1	0	3	3	Sales/assets	1.1	1.1	1.1	1.1	1.0
Payables	3,707	4,126	4,440	4,777	5,107	Assets/equity	184.7%	172.3%	168.3%	165.1%	162.2%
Others	164	176	184	193	202	ROE	18.0%	16.3%	16.2%	15.7%	15.1%
Total current liabilities	4,042	4,302	4,624	4,973	5,312	ROCE	17.4%	16.1%	16.2%	15.7%	15.0%
Long-term debt	25	10	10	8	5						
Other liabilities	370	370	370	370	370						
Total Liabilities	4,485	4,730	5,052	5,398	5,734						
Shareholder's equity	6,116	6,881	7,752	8,695	9,700						
BVPS (Rmb)	3.08	3.53	3.98	4.46	4.97						

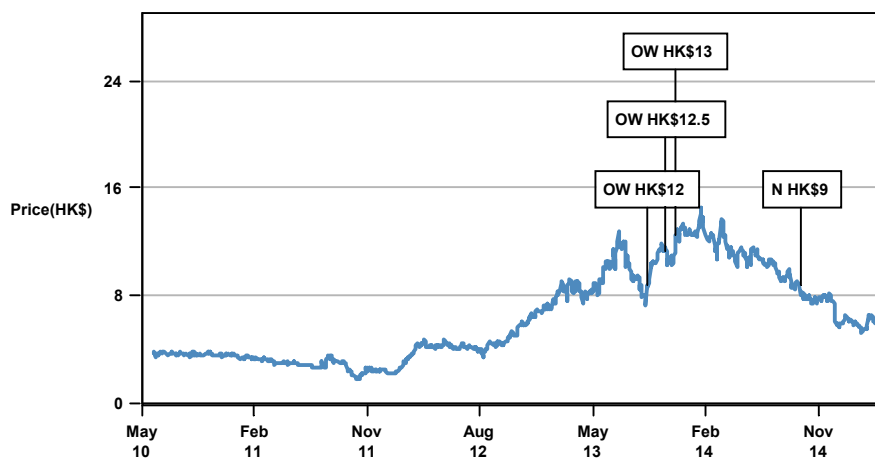
Source: Company reports and J.P. Morgan estimates.

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CIMC ENRIC HOLDINGS LTD (3899.HK, 3899 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
09-Sep-13	OW	8.79	12.00
22-Oct-13	OW	11.30	12.50
18-Nov-13	OW	12.52	13.00
16-Sep-14	N	8.70	9.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 09, 2013.

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IB clients*	75%	67%	52%

*Percentage of investment banking clients in each rating category.

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