

ZCSR [3898.HK]

**Enlargement of addressable market, more than a story.
Reiterate BUY**

During the analyst presentation, management expresses some subsidiaries of CNR have sought cooperation with ZCSR after the merger announcement of CSR and CNR. ZCSR has started to study the technological feasibility on such cooperation. Although sales growth of domestic railway products is expected to be slow from high-bases in FY14, the increase in overseas order booking is expected to offset the negative effect from domestic market slowdown. We revise our estimated FY15E-16E EPS upward for a higher expectation on overseas order booking, and assume a 10% of electrical component procurement for MUs and locomotive will be given to ZCSR by CNR in 2016. We maintain our target valuation at 23x FY15E PER, and lift target price to HK\$63.97, Maintain **BUY**.

- Enlargement of addressable market.** According to the management, some subsidiaries of CNR, such as CNR Datong, a key subsidiaries of CNR responsible for manufacturing locomotive, have approached ZCSR in order to seek cooperation after the announcement of merger of CSR and CNR. ZCSR has started to study on the technological feasibility on the cooperation. ZCSR will be granted an option to take priority in consolidating assets within the group from by CRRC, the resultant entity from merger of CSR and CNR, under non-competition agreement. Management expects to have more information in mid-2015, and start taking order from CNR as early in 2016.
- Overseas support the growth in FY15E.** Total sale of locomotive and MUs products (the key product segments accounted for 67% of total revenue in FY14) were up 62% YoY in FY14 due to the resumption of procurement from CRC since 2H13. Management expects the domestic sales growth will slow under the flat budgeted CAPEX of CRC for 2015 vs. 2014. However, based on the backlog on hand, Management believes the growth in overseas revenue will offset the slow of growth in domestic market. Targeted sale from overseas order FY15E is RMB 2bn vs. RMB 800m in FY14.
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Y/E Dec 31	2012	2013	2014	2015E	2016E
Revenue (RMBm)	7,186	8,781	12,576	15,708	19,232
Net Income (RMBm)	1,224	1,467	2,395	2,625	3,214
EPS (RMB)	1.129	1.332	2.038	2.234	2.736
Growth (% YoY)		18.03	52.98	9.60	22.45
PER (x)		28.81	18.84	17.19	14.04
BVPS (RMB)	5.705	7.673	9.354	11.188	13.477
PBR (x)		5.00	4.10	3.43	2.85
DPS(RMB)	0.350	0.373	0.400	0.447	0.547
Yield (%)		0.97	1.04	1.16	1.42
ROAE (%)	21.29	19.30	23.94	21.75	22.18
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Sources: Company, CGIHK Research estimates

Capital Goods

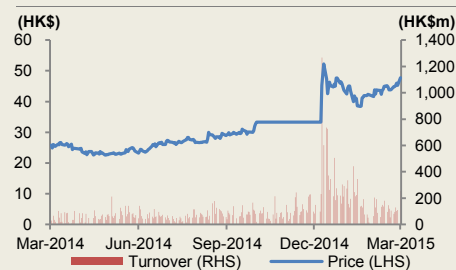
BUY

(Unchanged)

Close: HK\$ 47.80 (Mar 23, 2015)

Target Price: HK\$63.97 (33.8%)

Share Price Performance



Market Cap	US\$7,204m
Shares Outstanding	1,176m
Auditor	Ernst & Young
Free Float	48.19%
52W range	HK\$54.35-20.66
3M average daily T/O	US\$29m
Major Shareholding	CSR [1766 HK] (51.81%)

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- Short term impact on margin drag down.** GPM was up 2.2ppt YoY to 37% and net margin was up 2.3ppt YoY to 19% in FY14, due to the product-mix change with increase in contribution of locomotive and MUs products which is higher in GPM. Management expects the GPM of locomotive, MUs and metro products staying high at 35-40% in FY15. Due to the acquisition of SMD, a manufacturer of remotely operated trenching and mining machinery operating in deep-sea making net loss in FY12 and FY13, the overall GPM will be dragged down. Because business restructuring will take time, we assume the overall businesses maintain low profitability in FY15-16E. Nevertheless, the management expects new businesses will be the future growth driver of ZCSR given the domestic railway investment growth to be peaking off in 13th FYP vs. 12th FYP. The new businesses will grow fast and become profitable after 2016, such that the total earnings size to be double by 2020 vs. that in 2014, according to management .
- Maintain good financial position and reiterate BUY.** ZCSR maintained a net cash position at end-2014. Net cash (including the bank financial products) after deducting the acquisition cost of SMD and budgeted FY15E CAPEX is estimated at RMB3.6bn, which provided the group with enough financial resources for acquiring electrical component manufacturing assets from CNR group or in house capacity ramp up. We revise upward to our estimated FY15E and FY16E EPS for the higher expectation on overseas order booking, and assuming 10% of electrical component procurement will be given to ZCSR by CNR in 2016. We maintain our target valuation at 23x FY15E PER, and lift target price to HK\$63.97, **maintain BUY**.

Figure 1: Major change of our forecast

(RMBm)	FY15E			FY16E		
	Old	New	Change (%)	Old	New	Change (%)
Operating revenue	13,513	15,840	17.22	16,385	19,392	18.36
Train-borne electrical systems	10,526	11,021	4.70	12,169	13,666	12.30
Other rolling stock components	1,808	1,922	6.33	2,077	2,213	6.57
Others	1,179	2,896	145.64	2,138	3,513	64.33
Less: business tax	115	131	14.32	139	161	15.80
Revenue	13,398	15,708	17.24	16,245	19,232	18.38
Gross profit	4,828	5,476	13.43	5,801	6,675	15.06
GPM (%)	35.73	34.57	-1.15ppt	35.40	34.42	-0.99ppt
Net income	2,205	2,625	19.05	2,673	3,214	20.25
Net margin (%)	16.32	16.57	0.25ppt	16.31	16.57	0.26ppt
EPS	1.877	2.234	19.05	2.275	2.736	20.25

Sources: CGIHK Research estimates

Figure 2: Financial statements

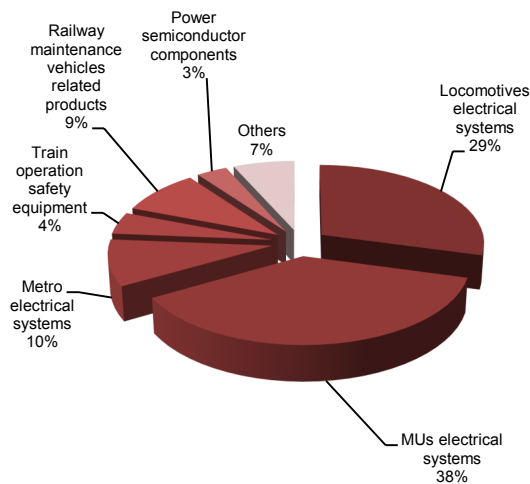
Consolidated income statement						Consolidated balance sheet					
FY Ended Dec 31 (RMBm)	FY12A	FY13A	FY14A	FY15E	FY16E	As of Dec 31 (RMBm)	FY12A	FY13A	FY14A	FY15E	FY16E
Operating revenue	7,249	8,856	12,676	15,840	19,392	Current assets	7,203	10,813	14,166	15,756	19,657
Train-borne electrical systems	4,741	6,177	9,671	11,021	13,666	Cash and equivalent	2,319	3,136	2,680	3,901	4,754
Other rolling stock components	1,589	1,674	1,723	1,922	2,213	Trade and bill receivables	3,628	4,908	5,998	7,285	8,967
Others	919	1,005	1,282	2,896	3,513	Inventories	1,110	1,428	2,207	2,278	3,226
Less: business tax	63	75	100	131	161	Other current assets	146	1,341	3,281	2,292	2,709
Revenue	7,186	8,781	12,576	15,708	19,232	Non-current assets	2,454	2,586	2,759	4,416	4,534
Less: COGS	4,803	5,695	7,876	10,232	12,557	PP&E	1,701	1,830	1,883	2,950	3,025
Gross profit	2,383	3,086	4,700	5,476	6,675	Land use right	160	173	201	203	205
Less: SG&A	1,197	1,503	2,230	2,773	3,359	Total intangible assets	111	74	81	543	546
Add: JV, associate & others	131	81	191	238	290	Long term investments	255	233	237	261	287
Operating profit	1,317	1,664	2,661	2,942	3,605	Other non-current assets	227	276	357	458	471
Add: Net fin income (cost)	9	27	43	27	37	Total assets	9,657	13,399	16,925	20,172	24,191
Add: JV, associate & others	78	13	51	50	55	Current liabilities	3,033	3,821	4,987	6,006	7,279
Pre-tax profit	1,404	1,704	2,755	3,019	3,697	Trade and bill payables	1,988	2,679	3,431	4,418	5,215
Less: Income tax	179	238	363	393	481	Receipts in advance	292	388	588	531	944
Total net profit	1,225	1,466	2,392	2,627	3,216	Short term borrowings	41	31	4	38	41
Less: Minority interests	1	(1)	(3)	2	2	Other current liabilities	712	723	964	1,020	1,079
Net income	1,224	1,467	2,395	2,625	3,214	Non-current liabilities	305	428	767	830	876
EPS (RMB)	1.129	1.332	2.038	2.234	2.736	Long-term borrowings	28	52	37	63	69
DPS (RMB)	0.350	0.373	0.400	0.447	0.547	Other non-current liabilities	277	376	730	767	806
EBIT	1,395	1,677	2,712	2,992	3,660	Total liabilities	3,338	4,249	5,754	6,836	8,155
EBITDA	1,542	1,837	2,983	3,305	3,970	Minority interests	135	134	180	190	201
						Shareholders' equity	6,184	9,016	10,991	13,146	15,835
						BVPS (RMB)	5.705	7.673	9.354	11.188	13.477
Consolidated cash flow statement						Key ratios					
FY ended Dec 31 (RMBm)	FY12A	FY13A	FY14E	FY15E	FY16E	FY ended Dec 31 (RMBm)	FY12A	FY13A	FY14A	FY15E	FY16E
Profit before tax	1,404	1,704	2,755	3,019	3,697	Sales mixed (%)					
Depreciation and amortization	147	160	271	313	310	Train-borne electrical systems	65.40	69.75	76.29	69.58	70.47
Changes in working capital	(21)	(867)	(957)	(483)	(1,465)	Other rolling stock components	21.92	18.90	13.59	12.14	11.41
Financial cost	16	3	3	6	6	Others	12.68	11.35	10.11	18.28	18.12
Income tax paid	(129)	(513)	(502)	(406)	(496)	Profit & loss ratios (%)					
Others	(170)	239	487	28	30	Gross margin	33.16	35.14	37.37	34.86	34.71
CF Operating	1,247	726	2,057	2,476	2,083	Net profit margin	17.03	16.71	19.04	16.71	16.71
Increase in PP&E	(382)	(293)	(403)	(2,086)	(390)	Effective tax rate	12.75	13.97	13.18	13.00	13.00
Increase in stake of JV	(807)	(1,101)	(4)	(24)	(26)	Growth (%)					
Others	1,205	67	(1,721)	1,000	-	Revenue	1.51	22.20	43.22	24.91	22.43
CF Investing	16	(1,327)	(2,128)	(1,110)	(416)	Gross profit	(3.91)	29.50	52.30	16.52	21.88
Capital injection	10	1,776	-	-	-	EBIT	(0.92)	20.22	61.72	10.33	22.31
Net debt financing	(632)	28	(42)	59	10	EBITDA	(0.06)	19.13	62.40	10.77	20.14
Dividend & interest paid	(397)	(382)	(410)	(467)	(527)	Net profit	3.38	19.85	63.26	9.60	22.45
Others	-	-	54	-	-	Balance sheet ratios					
CF Financing	(1,019)	1,422	(398)	(408)	(517)	Current ratio (x)	2.37	2.83	2.84	2.62	2.70
Net change in cash	244	821	(469)	958	1,150	Quick ratio (x)	2.01	2.46	2.40	2.24	2.26
						Cash ratio (x)	0.76	0.82	0.54	0.65	0.65
						Trade & bill receivables days	147	178	159	155	155
						Trade & bill payables days	127	150	142	140	140
						Inventory turnover days	106	81	84	80	80
						Total debt / equity ratio (%)	1.09	0.91	0.37	0.75	0.69
						Net debt / equity ratio (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
						Returns (%)					
						ROAE	21.29	19.30	23.94	21.75	22.18
						ROAA	13.38	12.72	15.78	14.16	14.50
						Payout ratio	31.05	28.02	19.62	20.00	20.00

Sources: CGIHK Research estimates

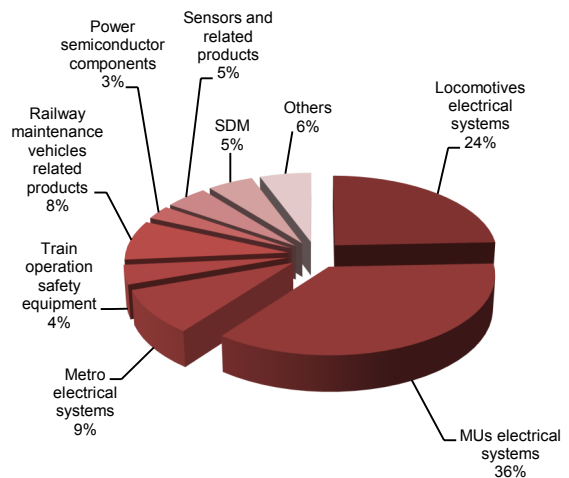
Figure 3: Financial summary

Financial summary	1H13	2H13	FY13	1H14	2H14	FY14	FY14 (% YoY)	2H14 (% YoY)
Operating revenue (RMBm)	2,624	6,232	8,856	5,180	7,496	12,676	43.13	20.28
Locomotives electrical systems	811	2,095	2,906	716	2,988	3,704	27.46	42.63
EMUs electrical systems	314	2,001	2,315	2,830	1,929	4,759	105.57	(3.60)
Metro electrical systems	421	535	956	504	704	1,208	26.36	31.59
Other train-borne systems	672	1,002	1,674	739	984	1,723	2.93	(1.80)
Electric components and others	406	599	1,005	391	891	1,282	27.56	48.75
Business taxes & surcharges (RMBm)	21	54	75	30	70	100	33.33	29.63
Revenue (RMBm)	2,603	6,178	8,781	5,150	7,426	12,576	43.22	20.20
Less: Operating cost (RMBm)	1,628	4,067	5,695	3,324	4,552	7,876	38.30	11.93
Gross Profit (RMBm)	975	2,111	3,086	1,826	2,874	4,700	52.30	36.14
GPM (%)	37.46	34.17	35.14	35.46	38.70	37.37	2.23ppt	4.53ppt
Selling cost (RMBm)	131	367	498	275	606	881	76.91	65.12
Administrative cost (RMBm)	366	639	1,005	494	855	1,349	34.23	33.80
SG&A (RMB mn)	497	1,006	1,503	769	1,461	2,230	48.37	45.23
SG&A-to-revenue (%)	19.09	16.28	17.12	14.93	19.67	17.73	0.62ppt	3.39ppt
Net profit (RMBm)	400	1,067	1,467	857	1,538	2,395	63.26	44.14
Net profit margin (%)	15.37	17.27	16.71	16.64	20.71	19.04	2.34ppt	3.44ppt
Total debt (RMBm)	66	83		60	42		(49.40)	(49.40)
Total cash and equivalents (RMBm)	1,583	3,136		2,729	2,680		(14.54)	(14.54)
Net debt (cash) (RMBm)	(1,517)	(3,053)		(2,669)	(2,638)		(13.59)	(13.59)
Total equity (RMBm)	6,307	9,150		9,656	11,171		22.09	22.09
Net gearing (%)	(24.05)	(33.37)		(27.64)	(23.61)		N/A	9.75ppt

Sources: Company, CGIHK Research

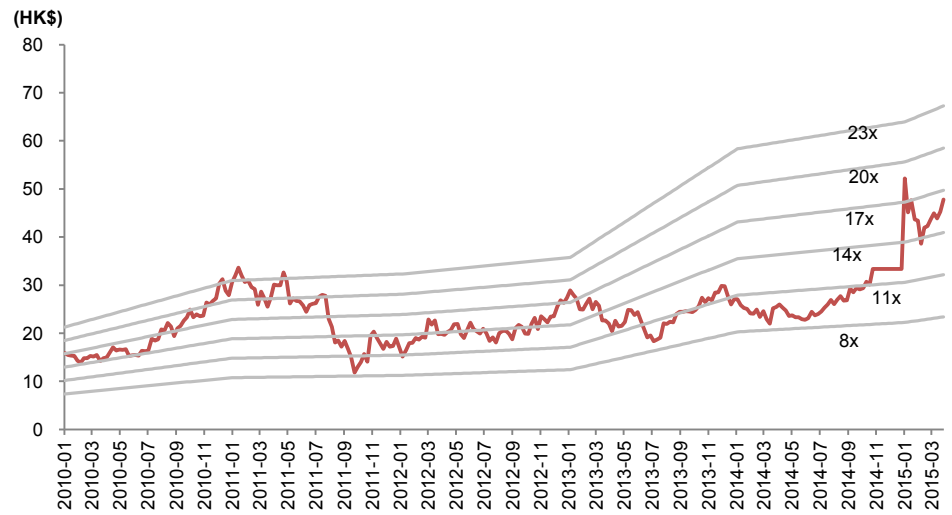
Figure 4: Total revenue breakdown by sectors of ZCSR, FY14


Sources: Company, CGIHK Research

Figure 5: Total revenue breakdown by sectors of ZCSR, FY15E


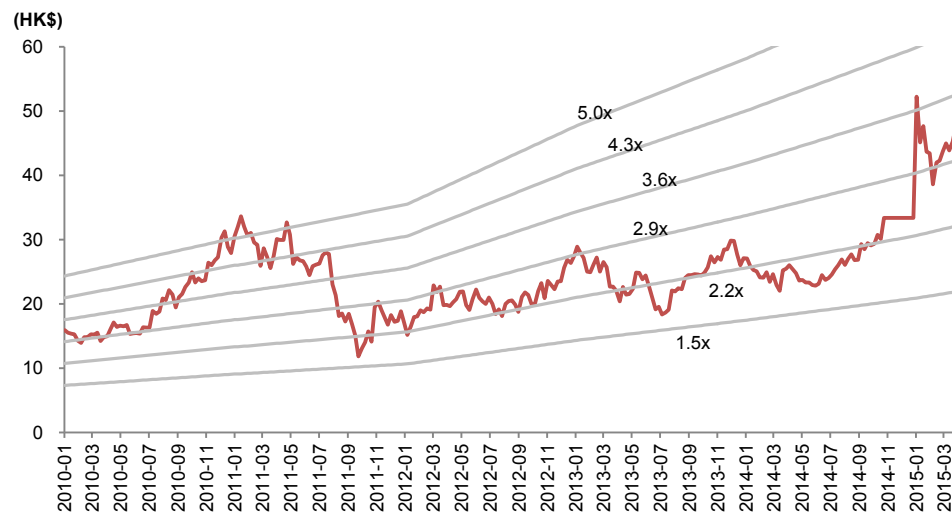
Sources: CGIHK Research estimates

Figure 6: PER band of ZCSR in 1M10-3M15



Sources: Bloomberg, CGIHK Research

Figure 7: PBR band of ZCSR in 1M10-3M15



Sources: Bloomberg, CGIHK Research

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