

JPM-pp1

Asia Pacific Equity Research

30 March 2015

# China High Speed Transmission (658 HK)

Overweight

Price: HK\$5.10

27 Mar 2015

Price Target: HK\$8.00

PT End Date: 30 Jun 2015

FY14 results in line, but growth slowdown in 2H14 on surging finance costs

- **FY14 results in line:** China High Speed announced FY14 results over the weekend. Stripping away non-core items of Rmb306MM (mainly impairment provisions/write-down on receivables/inventories and disposal losses on JV, see below), core pre-tax profits of Rmb613MM represented a 16% Y/Y increase and were largely in line with market estimates. While no details were disclosed, we believe the earnings growth was driven mainly by recovery in the wind gearbox segment (revenue up +40% Y/Y), but was partly offset by: (1) weakness in other conventional segments (e.g. gears for construction (revenue down 10% Y/Y) and gears for bar-rolling (down 39%)) and (2) surging finance costs (+31% Y/Y). That might explain why Goldwind (a pure wind player) delivered stronger Y/Y earnings growth (>+500% Y/Y).
- **Finance costs increased** by 11% H/H and 41% Y/Y in 2H2014, as the company refinanced some of the short-term debt with longer-term financing, but at a higher interest rate.
- **Impairment provisions on assets (e.g. receivables/inventories)** declined from Rmb385MM in 2013 to Rmb123MM in 2014 (down 68% Y/Y), mainly driven by demand recovery on wind gearboxes as wind farm operators rush installations in anticipation of impending feed-in tariff cuts.
- **Net gearing eased slightly** to 107% as of Dec 2014 from 116% in Jun 2014, although still higher than Dec 2013 levels (85%).
- **Preferred equipment play:** We expect wind turbine demand to surge further this year in light of impending tariff cuts in China. But the outlook remains uncertain beyond 2015. On a relative basis, we prefer China High Speed more thanks to the less demanding valuation.
- **Analyst briefing will be held on 30 March 2015 (Monday)** at 9:30 a.m.-10:30 a.m in Aberdeen Room(Level 3), JW Marriott Hotel Hong Kong, Pacific Place, 88 Queensway, HK.

Table 1: Summary of FY14 results

RMB MM	1H12	1H13	1H14	2H12	2H13	2H14	Y/Y	2012	2013	2014	Y/Y
<b>Turnover</b>	<b>3,293</b>	<b>2,640</b>	<b>3,947</b>	<b>3,076</b>	<b>3,899</b>	<b>4,200</b>	8	<b>6,369</b>	<b>6,539</b>	<b>8,147</b>	25
Cost of sales	(2,435)	(2,108)	(2,937)	(2,380)	(2,801)	(3,190)	14	(4,815)	(4,908)	(6,127)	25
<b>Gross profit</b>	<b>857</b>	<b>533</b>	<b>1,010</b>	<b>696</b>	<b>1,098</b>	<b>1,010</b>	(8)	<b>1,553</b>	<b>1,631</b>	<b>2,020</b>	24
Other gain / income, net	77	105	172	138	228	228	(0)	215	334	400	20
Selling and admin expenses	(400)	(434)	(447)	(381)	(460)	(537)	17	(781)	(895)	(984)	10
R&D	(50)	(40)	(71)	(88)	(99)	(97)	(2)	(138)	(139)	(167)	20
Others	(61)	(170)	(62)	(57)	(108)	(159)	46	(118)	(278)	(220)	(21)
<b>Operating Profits (EBIT)</b>	<b>423</b>	<b>(6)</b>	<b>603</b>	<b>309</b>	<b>659</b>	<b>445</b>	(32)	<b>732</b>	<b>653</b>	<b>1,048</b>	61
Interest expenses	(257)	(287)	(352)	(267)	(277)	(390)	41	(524)	(564)	(742)	31
<b>Profit Before Tax (PBT)</b>	<b>166</b>	<b>(293)</b>	<b>251</b>	<b>42</b>	<b>381</b>	<b>55</b>	(86)	<b>208</b>	<b>88</b>	<b>307</b>	247
Tax	(83)	(23)	(36)	3	(34)	(95)	180	(79)	(57)	(131)	129
<b>Profit Before MI</b>	<b>83</b>	<b>(316)</b>	<b>215</b>	<b>45</b>	<b>348</b>	<b>(40)</b>	(111)	<b>128</b>	<b>31</b>	<b>176</b>	464
MI	13	27	19	(3)	6	14	116	10	33	33	(2)
<b>Net profit</b>	<b>96</b>	<b>(289)</b>	<b>235</b>	<b>42</b>	<b>354</b>	<b>(26)</b>	(107)	<b>138</b>	<b>65</b>	<b>208</b>	223
<b>EPS (Rmb /share)</b>	<b>0.07</b>	<b>(0.21)</b>	<b>0.14</b>	<b>0.03</b>	<b>0.26</b>	<b>(0.02)</b>	(106)	<b>0.10</b>	<b>0.05</b>	<b>0.13</b>	170
Gross mgn (%)	26	20	26	23	28	24	(4)	24	25	25	(0)

EBIT mgn (%)	13	(0)	15	10	17	11	(6)	11	10	13	3
<b>Revenue breakdown</b>											
High speed gears	3	3	5	5	8	10	32	8	11	15	34
Gears for construction	243	129	175	231	233	153	(35)	474	363	328	(10)
General purpose gear	53	36	29	38	27	34	24	91	64	63	(0)
Gear for bar-rolling / wire-rolling	288	157	161	253	299	116	(61)	541	456	277	(39)
Wind gear	2,238	1,665	2,788	1,714	2,476	3,014	22	3,952	4,140	5,802	40
Marine gear	87	134	174	164	206	176	(15)	251	341	350	3
High speed locomotives	53	34	70	27	72	88	22	80	106	158	48
Others	327	482	545	644	577	609	6	972	1,059	1,155	9
<b>Total</b>	<b>3,293</b>	<b>2,640</b>	<b>3,947</b>	<b>3,076</b>	<b>3,899</b>	<b>4,200</b>	<b>8</b>	<b>6,369</b>	<b>6,539</b>	<b>8,147</b>	<b>25</b>

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

Table 2: Reconciliation of core-pre-tax profits

Rmb MM	2013	2014	Y/Y
<b>PBT - reported</b>	<b>88</b>	<b>307</b>	249%
Write-down of inventories (included in COS)	223	39	-82%
Gain on disposal of available-for-sale investments	(39)	(1)	-97%
Net exchange (losses) gains	(20)	32	-260%
Loss on disposal of a joint venture	-	130	N/A
Gain on disposal of a subsidiary	-	(4)	N/A
Loss on disposal of property, plant and equipment	46	1	-98%
Changes in fair value of held-for-trading financial liabilities	-	2	N/A
Impairment losses on intangible assets (included in other expenses)	21	48	129%
Impairment losses on trade and other receivables (included in other expenses)	141	36	-74%
Impairment losses on goodwill (included in other expenses)	15	-	N/A
Impairment losses on interests in a joint venture (included in other expenses)	53	-	N/A
Impairment loss on property, plant and equipment (included in cost of sales)	-	23	N/A
<b>Total</b>	<b>440</b>	<b>306</b>	-30%
<b>Core PBT</b>	<b>528</b>	<b>613</b>	16%

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

## Investment Thesis

Located in Nanjing, Jiangsu Province, China High Speed Transmission is one of the leading and most established wind gearbox producers in China. The company has strong business ties with GE and is building an increasingly important presence in the global wind gearbox market. The company also produces gearboxes for other industry sectors, including marine, construction, steel and mining. Our bullish view on the company is thanks to its sequential improvement on a Q/Q basis.

## Valuation

Our Jun-15 price target of HK\$8.00 is based on DCF with an 11.9% WACC and a 2% terminal growth.

## Risks to Rating and Price Target

Downside risk to our PT includes lower-than-expected margin on wind gearboxes due to intense market competition on turbine suppliers. Upside risk includes

higher-than-expected demand for wind gearboxes due to weak demand for direct drive turbine technologies.

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China wind

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Date	Rating	Share Price (HK\$)	Price Target (HK \$)
15-May-08	UW	14.52	12.80
18-Sep-08	N	12.98	12.80

<http://gps-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=505102&shareClassServerId=4&chartDesignation=1&actionType=C>

17-Mar-09	OW	9.54	12.80
20-Apr-09	OW	11.66	15.10
13-May-09	OW	13.84	15.80
11-Nov-09	OW	16.78	21.50
06-May-10	OW	17.68	24.30
18-Feb-11	N	11.84	13.50
07-Oct-11	N	3.20	3.00
27-Aug-12	N	2.55	2.60
11-Apr-13	OW	3.40	4.60
26-Aug-13	OW	3.22	4.60
09-Oct-13	OW	3.64	4.40
01-Apr-14	OW	5.79	7.00
02-Sep-14	OW	6.73	8.20
30-Sep-14	OW	6.37	8.00

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