

Johnson Electric Holdings

Lowering PT to HK\$29: Another tough year of integration before turnaround

JE is one of the largest producers of micro motors in China; micro motors are used in autos and consumer products. JE reported disappointing FY16 results with an 18% drop in NP for FY16 Y/Y which was 12% lower than expectations. We see many of the key factors dampening JE's profits in FY16 to be temporary and we see the revised CY16 P/E of 10-11x as attractive against peers. We remain OW with a lower PT of HK\$29.

- Headwinds unusually heavy in FY16.** FY16 net profit fell for the first time in about 7 years due to many negative factors hurting growth and profits. These include non-operating factors such as depreciating currencies and M&A related costs, but they also include some longer term problems such as a slowdown in IPG sales in Asia as well as startup losses in many new plants that are taking much longer to become profitable. Many of these headwinds could become less significant in FY17 compared to FY16. Longer term, growth in automotive components driven by new products, new production facilities and new brands (acquired recently) are the key factors behind a re-rating of JE.
- Lowering FY17 earnings by 12% and taking PT down to HK\$29.** Due to the disappointment seen in FY16 (mainly sales decline in IPG as well as a sharp decline in GPM), we have adjusted our FY17 and FY18 estimates accordingly. We do expect lower GPM for JE for FY17 to factor in the drag to GPM from the newly acquired businesses, which would take some time for JE to turn around and improve the profitability to group levels. We have lowered our NP for FY17 and FY18 by 11% and 8% respectively and our revised FY17 EPS est. is 2% lower than consensus.
- Price, valuation and risks.** Our DCF-based Dec-16 PT of \$29.0 implies CY17E P/E of 15x. Key risks include rising material costs, uncertainty over the sustainability of the US auto recovery, the company's ability to penetrate the PRC auto market, Rmb appreciation and higher commodity prices lifting costs.

Overweight

0179.HK, 179 HK

Price: HK\$20.55

▼ **Price Target: HK\$29.00**
Previous: HK\$34.00

China

SMID-Caps

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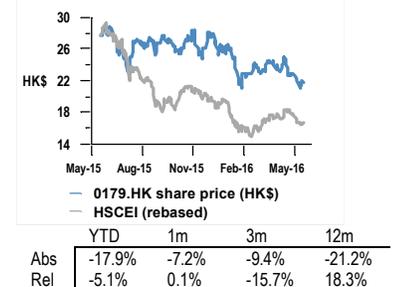
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Price Performance



Johnson Electric Holdings (Reuters: 0179.HK, Bloomberg: 179 HK)

| \$ in mn, year-end Mar | FY13A | FY14A | FY15A | FY16A | FY17E |
|------------------------|--------|-------|-------|---------|-------|
| Revenue (\$ mn) | 2,079 | 2,098 | 2,136 | 2,236 | 2,566 |
| Net Profit (\$ mn) | 211 | 208 | 211 | 173 | 208 |
| EPS (\$) | 0.23 | 0.23 | 0.23 | 0.19 | 0.23 |
| DPS (\$) | 0.06 | 0.06 | 0.06 | 0.06 | 0.07 |
| Revenue growth (%) | (2.9%) | 0.9% | 1.8% | 4.7% | 14.8% |
| EPS growth (%) | 14.1% | 0.1% | 1.6% | (17.5%) | 20.3% |
| ROCE | 11.5% | 11.1% | 10.3% | 8.8% | 9.9% |
| ROE | 12.6% | 12.6% | 11.7% | 10.0% | 11.3% |
| P/E (x) | 11.5 | 11.5 | 11.3 | 13.7 | 11.4 |
| P/BV (x) | 1.5 | 1.4 | 1.3 | 1.3 | 1.2 |
| EV/EBITDA (x) | 8.1 | 7.1 | 6.9 | 9.7 | 7.6 |
| Dividend Yield | 2.1% | 2.2% | 2.3% | 2.4% | 2.8% |

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

| Company Data | |
|------------------------------|-----------|
| Shares O/S (mn) | 925 |
| Market Cap (\$ mn) | 2,450 |
| Market Cap (\$ mn) | 2,450 |
| Price (HK\$) | 20.55 |
| Date Of Price | 18 May 16 |
| Free Float(%) | - |
| 3M - Avg daily vol (mn) | 0.35 |
| 3M - Avg daily val (HK\$ mn) | 8.09 |
| 3M - Avg daily val (\$ mn) | 1.0 |
| HSCEI | 8425.78 |
| Exchange Rate | 7.76 |
| Price Target End Date | 31-Dec-16 |

See page 11 for analyst certification and important disclosures, including non-US analyst disclosures.

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| | | |
|--|--|--|
| <p>Key catalysts for the stock price:</p> <ul style="list-style-type: none"> • Signs of improved pricing power in EU as auto related demand improves • New products may be introduced such as motors for electric vehicles and smart meters • A trend of improving margins over the next few years as demand is strong and costs are well controlled | <p>Upside risks to our view:</p> <ul style="list-style-type: none"> • Lower Rmb improves cost competitiveness of JE • Strong recovery in EU demand for auto relate motors • Industrial motor demand from developed markets improving | <p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Rising material costs (copper , steel) and wage inflation to crimp margins • Poor economic environment may dampen demand in China • Health of US auto market may deteriorate after several years of recovery |
|--|--|--|

| Key financial metrics | FY14 | FY15 | FY16 | FY17E |
|-----------------------------|-------|-------|--------|-------|
| Revenues (LC) | 2,098 | 2,136 | 2,236 | 2,566 |
| Revenue growth (%) | 0.9% | 1.8% | 4.7% | 14.8% |
| EBITDA (LC) | 297 | 313 | 298 | 384 |
| EBITDA margin (%) | 14.1% | 14.6% | 13.3% | 14.9% |
| Tax rate (%) | 15% | 15% | 12% | 12% |
| Net profit (LC) | 208 | 211 | 173 | 208 |
| EPS (LC) | 0.230 | 0.234 | 0.193 | 0.232 |
| EPS growth (%) | 0.1% | 1.6% | -17.5% | 20.3% |
| DPS (LC) | 0.06 | 0.06 | 0.06 | 0.07 |
| BVPS (LC) | 1.95 | 2.09 | 2.10 | 2.26 |
| Operating cash flow (LC mn) | 298 | 262 | 245 | 329 |
| Free cash flow (LC mn) | 198 | 91 | (609) | 49 |
| Interest cover (x) | -33 | -40 | 65 | 40 |
| Net margin (%) | 9.9% | 9.9% | 7.7% | 8.1% |
| Sales/assets (X) | 0.88 | 0.80 | 0.75 | 0.79 |
| Debt/equity (%) | 6.7% | 15.3% | 22.6% | 21.1% |
| Net debt/equity (%) | NC | NC | NC | NC |
| ROE (%) | 13% | 12% | 10% | 11% |

| Key model assumptions | FY14 | FY15 | FY16 | FY17E |
|-------------------------|-------|-------|-------|-------|
| Auto related (y/Y) | 6.5% | 3.4% | 10.1% | 21.3% |
| Industrial motors (Y/Y) | -4.0% | 3.1% | -7.0% | -2.0% |
| Gross profit margin | 29.5% | 29.6% | 26.4% | 26.9% |

Source: Company and J.P. Morgan estimates.

| Sensitivity analysis | EBITDA | | EPS | |
|---------------------------------|--------|-------|-------|-------|
| Sensitivity to | FY16E | FY17E | FY16E | FY17E |
| Auto related volume growth (5%) | 8.4% | 7.8% | 11.2% | 11.1% |
| Ind related volume (5%) | 3.3% | 2.5% | 4.4% | 3.5% |
| 1% chg in GPM | 8.6% | 7.6% | 11.5% | 10.9% |

Source: J.P. Morgan estimates.

Peer Comparison

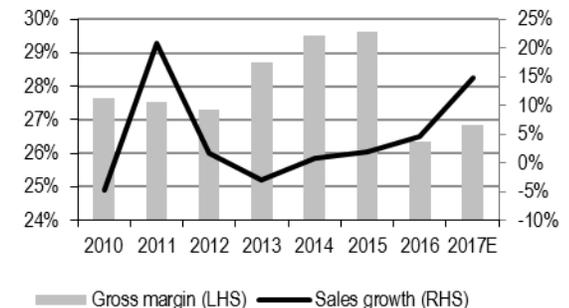
| Company Name | Code | Price Local ccy | MCAP US\$MM | Vol US\$m | 3M Chg | 16e P/E (x) | 17e PE(x) | ROE (%) | P/B (x) | Yld (%) |
|-------------------------|---------------|--------------------|----------------|--------------|---------------|----------------|--------------|-------------|------------|------------|
| CHINA STATE CONS | 3311 HK | 10.4 | 5,408.4 | 10.2 | (15.4) | 8.4 | 6.6 | 22.8 | 1.8 | 3.5 |
| ND PAPER | 2689 HK | 5.4 | 3,215.6 | 4.8 | 4.1 | 10.7 | 8.3 | 5.7 | 0.9 | 1.6 |
| LM PAPER | 2314 HK | 4.9 | 2,870.6 | 3.4 | 4.0 | 8.2 | 8.0 | 13.4 | 1.4 | 4.3 |
| XINYI GLASS HOLD | 868 HK | 5.3 | 2,632.0 | 5.5 | 22.2 | 8.9 | 7.1 | 16.5 | 1.4 | 5.0 |
| JOHNSON ELECTRIC | 179 HK | 20.5 | 2,304.2 | 0.9 | (15.8) | 10.5 | 9.3 | 10.1 | 1.6 | 2.3 |
| HAITIAN | 1882 HK | 11.7 | 2,398.1 | 2.0 | 17.7 | 11.5 | 10.6 | 16.3 | 1.6 | 3.0 |
| KINGBOARD CHEM | 148 HK | 15.7 | 2,061.7 | 3.6 | 38.3 | 7.7 | 6.1 | 5.8 | 0.4 | 3.9 |
| CHINA LESSO | 2128 HK | 4.0 | 1,598.9 | 3.6 | (9.9) | 4.8 | 3.8 | 20.2 | 0.9 | 5.3 |
| KB LAM | 1888 HK | 4.0 | 1,538.5 | 0.7 | 32.5 | 8.3 | 8.0 | 10.7 | 0.8 | 6.2 |
| JIANGNAN GP | 1366 HK | 1.2 | 643.2 | 0.9 | 17.1 | 5.3 | 4.5 | 15.4 | 0.9 | 4.9 |
| Average | | | | | 12.2 | 8.4 | 7.3 | 12.7 | 1.1 | 4.1 |

Source: Company data, Bloomberg estimates for NC stocks, J.P. Morgan estimates. Share prices are as of 18 May 2016.

Valuation and price target basis

Our price target is based upon DCF methodology. The nature of the industry leads us to apply a terminal growth of 3% (the lower end of the 3 to 6 percent growth rate used for SMID Caps).

Sales growth and GPM trends



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

JPM vs. consensus, change in estimates

| EPS (LC) | FY17E | FY18E |
|-----------|-------|-------|
| JPM old | 0.260 | 0.288 |
| JPM new | 0.232 | 0.264 |
| % chg | -11% | -8% |
| Consensus | 0.237 | 0.260 |

Source: Bloomberg, J.P. Morgan estimates.

Highlights from the year end results

Headwinds in FY16. Many adverse factors caused JE to have its first major (>5%) drop in net profit since 2009. These include the depreciation of the Euro (Euro denominated sales of 30-35% for JE) of over 15% Y/Y in FY16; a sharp 17% drop in sales of the industrial products group (IPG) in Asia due to the loss of low end customers to competitors on pricing; one-off acquisition related legal and other costs totaling \$12m and losses on start up production facilities in Serbia and Mexico. Demand for products from the automotive products group (APG) was stable with constant currency growth of 4-5% in all regions (still down 2% in US\$ terms). Most of these factors are less relevant in FY17 compared to FY16 and we do expect FY17 net profit to recover to the level of FY15 (FY17 net profits include some profits from newly acquired businesses not existing in FY15.)

No pricing power demonstrated in FY16. We have not seen any benefits of lower raw material costs as well as the depreciating Rmb in FY16, which have helped boost margins for some other exporters from China. The clear reason is that JE has a disproportionate high level of sales in regions with depreciating currencies (Europe, Latin America, Canada) and the impact of falling currencies prevented it from getting any margin improvements from the lower cost of production (more or less reflected in lower prices for customers) resulting in over a 3% drop in GPM. However, FY17 could be an interesting year as most currencies look to be stabilizing against the US\$ and we look forward to a mild 0.5% increase from FY16 GPM levels (lowest in 7 years).

Integration upside to new M&A. We believe that the newly acquired APG businesses of Stackpole (pumps, powdered metals) and AML (headlamps) give JE an opportunity to increase sales in the APG business as well as introduce new higher value added integrated components. For example, JE is developing an integrated motor/pump that can be cheaper and lighter and more efficient compared to existing products (motors and pumps in separate units).

Investing heavily for future growth. JE is adding capacity in Mexico, India, Serbia and a few other countries in order to boost production (mostly APG) in those regions and better service its automotive clients. The company is doing this despite sluggish demand and under-utilized Chinese based facilities in order to cater to longer term growth for JE. While it may be cheaper and more efficient to do production in China, JE cannot service some time and service demanding clients properly without localized production. However, having approx. 20 production facilities across the globe does cause significant startup costs and lower margins when key plants

are ramped up. The biggest location outside of China is in Mexico (commenced 2012 and size increased in 2015) which is still making a loss.

Results review for FY16

Sales growth of 5% Y/Y was 1% better than our expectations. Sales growth was impacted by currency movements and a mid-year acquisition; excluding these factors, sales growth would have been 2%. However, the drop in GPM to 26.4% (down 3.2% Y/Y) was much more severe than the 1% drop that we (and consensus) estimated for FY16.

The reason for the lower-than-expected GPM is due to adverse currency impact from euro-denominated sales plus the fact that the newly acquired auto parts business in the US in mid-FY16 (Stackpole acquisition) is likely to have lower margins compared to JE's existing business until efficiencies can be achieved by JE over the longer term.

Overall NP fell 18% (12% below our expectations) and about 15% below consensus due to the currency impact of a falling euro as well as a one-off M&A-related cost of US\$12m, which is non-recurring in nature. Shares have been quite weak (underperforming the Hang Seng Index by 15% in the past three months) and near a two-year low, so we do not believe that the results (mostly disappointing due to currency and M&A costs) will have much negative impact on the shares. Longer term, we need to see stronger sales growth driven by automotive and new industrial demand before sentiment improves.

| Year to Mar (US\$ mn) | FY15A | FY16A | Growth | FY16E | Variance |
|-----------------------|-------|-------|--------|-------|----------|
| Turnover | 2,136 | 2,235 | 4.6% | 2,209 | 1.2% |
| Gross profit | 632 | 590 | -6.8% | 632 | -6.7% |
| GPM | 29.6% | 26.4% | | 28.6% | |
| EBIT | 243 | 207 | -14.7% | 243 | -14.7% |
| Net profit | 211 | 173 | -18.1% | 197 | -12.4% |
| EPS (HKD) | 0.236 | 0.198 | -16.3% | 0.219 | -9.8% |

Source: Company, J.P. Morgan estimates.

Lowering FY17 earnings by 12% and taking PT down to HK\$29

Due to the disappointment seen in FY16 (mainly sales decline in IPG as well as a sharp decline in GPM), we have adjusted our FY17 and FY18 estimates accordingly. We now assume organic sales growth for APG (without acquisitions) of 2% in US\$ and a decline in IPG sales of 2% in US\$ Y/Y. Our overall sales estimate has not been lowered significantly because we are including the sales of the newly acquired French auto component maker AML as well as higher sales contribution from the FY16 acquisition of Stackpole pump maker. We do expect lower GPM for JE for FY17 to factor in the drag to GPM from the newly acquired businesses, which could take some time for JE to turn around and improve profitability at the group level. We have lowered our NP estimate for FY17 and FY18 by 11%

and 8% respectively and our revised FY17 EPS est. is 2% lower than consensus. We have lowered our DCF based Dec 16 PT to HK\$29 (prev. HK\$34).

| Year to Mar (US\$) | ----- New ----- | | ----- Old ----- | | ----- Change ----- | |
|--------------------|-----------------|-------|-----------------|-------|--------------------|-------|
| | FY17E | FY18E | FY17E | FY18E | FY17E | FY18E |
| Turnover | 2,566 | 2,678 | 2,526 | 2,608 | 1.6% | 2.7% |
| Gross profit | 689 | 738 | 741 | 777 | -6.9% | -5.1% |
| EBIT | 264 | 295 | 296 | 319 | -10.7% | -7.5% |
| Net profit | 208 | 236 | 234 | 259 | -11.4% | -9.0% |
| EPS (HKD) | 0.232 | 0.264 | 0.260 | 0.288 | -10.7% | -8.2% |
| Assumptions | | | | | | |
| Gross margin | 26.9% | 27.6% | 29.3% | 29.8% | -2.4% | -2.2% |

Source: Company, J.P. Morgan estimates.

Valuation and share price analysis

DCF valuation

Our Dec-16 PT is based on a DCF valuation that assumes a market risk premium of 6.0% and a risk free rate of 4.2% (yield on 10-year government notes in China). We have assumed a beta of 0.9. Accordingly, WACC is assumed at 9.6%. We have estimated free cash flow for JE until 2020 and assume a terminal growth rate of 3%. The terminal growth is based on the annual growth rate expected in 2020 (the final year of the estimate period) subject to a minimum of 3% and a maximum of 6% depending on the nature of the industry and the level of maturity in China.

We also analyzed the DCF price sensitivity to WACC, and the terminal multiple.

Table 1: XYG – base-case DCF analysis

| HK\$ in millions, year-end Dec | 2013 | 2014E | 2015 | 2016E | 2017E | 2018E | 2019E | Terminal |
|--|--------------|-------------------------------|------------|-----------|------------|-----------------|------------|------------|
| Cash flow estimates | | | | | | | | |
| Sales | 2,079 | 2,098 | 2,136 | 2,236 | 2,566 | 2,678 | 2,740 | 2,804 |
| EBIT | 212 | 234 | 243 | 219 | 264 | 295 | 321 | 348 |
| NOPAT | 189 | 222 | 211 | 201 | 231 | 254 | 273 | 292 |
| Capex, net | (83) | (92) | (120) | (186) | (192) | (161) | (164) | (168) |
| Depreciation | 69 | 63 | 70 | 79 | 119 | 128 | 134 | 139 |
| Change in working capital | (87) | 23 | (23) | (24) | (31) | (9) | 11 | 0 |
| Free operating CF (FoCF) | 89 | 215 | 139 | 72 | 130 | 217 | 258 | 269 |
| DCF Parameters | | | | | | | | |
| Liabilities as a % of EV | 0% | Assumptions | | | | Terminal growth | 3.0% | |
| WACC | 9.6% | Risk-free rate | | | | 4.2% | | |
| Enterprise NPV (10-16E) | | | | | | | | |
| + Net cash (debt), 14E | 3,667 | Market risk | | | | 6.0% | | |
| - Minorities (Market value) | (268) | Beta | | | | 0.90 | | |
| +/- Other items | (120) | Cost of debt | | | | 6.2% | | |
| = Equity value | 3,279 | Implied exit P/E multiple (x) | | | | 15x | | |
| / Number of shares | 879 | | | | | | | |
| = Equity value per share (HK\$) | 29.0 | | | | | | | |

Source: Company data, J.P. Morgan estimates

Table 2: XYG – Sensitivity analysis based on WACC and perpetual terminal growth rate

| | | Terminal growth rate | | | | | | |
|------|-------|----------------------|------|------|------|------|------|------|
| | | 1.5% | 2.0% | 2.5% | 3.0% | 3.5% | 4.0% | 4.5% |
| WACC | 8.1% | 30.2 | 32.6 | 35.5 | 38.9 | 43.1 | 48.3 | 54.9 |
| | 8.6% | 27.7 | 29.8 | 32.2 | 35.1 | 38.5 | 42.6 | 47.7 |
| | 9.1% | 25.6 | 27.4 | 29.5 | 31.8 | 34.6 | 38 | 42.1 |
| | 9.6% | 23.8 | 25.3 | 27.1 | 29.1 | 31.5 | 34.2 | 37.5 |
| | 10.1% | 22.2 | 23.5 | 25 | 26.8 | 28.8 | 31.1 | 33.8 |
| | 10.6% | 20.7 | 21.9 | 23.2 | 24.7 | 26.4 | 28.4 | 30.7 |
| | 11.1% | 19.4 | 20.5 | 21.6 | 22.9 | 24.4 | 26.1 | 28.1 |

Source: J.P. Morgan estimates.

Table 4: P&L statement

| US\$ MM, year-end Mar | 2014 | 2015 | 2016 | 2017E | 2018E |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Total Revenues | 2,098 | 2,136 | 2,236 | 2,566 | 2,678 |
| YoY change (%) | 0.9% | 1.8% | 4.7% | 14.8% | 4.4% |
| Cost of Goods Sold | (1,479) | (1,504) | (1,646) | (1,877) | (1,940) |
| YoY change (%) | -0.2% | 1.7% | 9.5% | 14.0% | 3.4% |
| Gross Profit | 619 | 633 | 589 | 689 | 738 |
| YoY change (%) | 3.7% | 2.2% | -6.8% | 16.9% | 7.1% |
| Gross Margin | 29.5% | 29.6% | 26.4% | 26.9% | 27.6% |
| SGA | (405) | (408) | (399) | (458) | (478) |
| YoY change (%) | 3.1% | 0.6% | -2.2% | 14.8% | 4.4% |
| Other Income/(Expenses) | 20 | 18 | 28 | 33 | 34 |
| Operating profit | 234 | 243 | 219 | 264 | 295 |
| EBITDA | 297 | 313 | 298 | 384 | 423 |
| EBITDA margin | 14.1% | 14.6% | 13.3% | 14.9% | 15.8% |
| Depreciation & Amortization | (63) | (70) | (79) | (119) | (128) |
| YoY change (%) | -7.9% | 10.6% | 12.5% | 51.7% | 7.5% |
| EBIT | 234 | 243 | 219 | 264 | 295 |
| EBIT margin | 11.1% | 11.4% | 9.8% | 10.3% | 11.0% |
| Net Interest Expense | 9 | 6 | (3) | (10) | (10) |
| Exceptional item | 0 | 0 | (12) | (8) | 0 |
| Associates | 0 | 1 | 3 | 3 | 3 |
| Gains/losses | 0 | 0 | 0 | 0 | 0 |
| Net Income Before Taxes | 243 | 249 | 207 | 250 | 287 |
| YoY change (%) | 2.3% | 2.6% | -17.1% | 20.9% | 15.1% |
| Tax | (28) | (29) | (24) | (30) | (37) |
| Effective Tax rate | 11.6% | 11.3% | 11.0% | 12.0% | 13.0% |
| Minority Interests | (7) | (9) | (10) | (12) | (14) |
| Net Income | 208 | 211 | 173 | 208 | 236 |
| YoY change (%) | -1.3% | 1.5% | -18.2% | 20.3% | 13.7% |
| Net margin | 9.9% | 9.8% | 7.6% | 8.0% | 8.7% |

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

Table 5: Interim estimates

| US\$ MM, year-end Mar | 1H15 | 2H15 | 1H16 | 2H16 | 1H17E | 2H17E |
|-------------------------|-------|-------|--------|---------|-------|---------|
| Total Revenues | 1,080 | 1,057 | 1,022 | 1,214 | 1,293 | 1,273 |
| Gross Profit | 326 | 307 | 282 | 307 | 338 | 351 |
| EBIT | 125 | 118 | 115 | 104 | 133 | 131 |
| Net Income Before Taxes | 129 | 121 | 115 | 91 | 126 | 124 |
| Net Income | 109 | 102 | 98 | 75 | 104 | 103 |
| Diluted EPS (HK\$) | 0.121 | 0.115 | 0.109 | (0.109) | 0.117 | (0.117) |
| Ratios | | | | | | |
| Revenue split | 50.5% | 49.5% | 45.7% | 54.3% | 50.4% | 49.6% |
| GPM | 30.2% | 29.0% | 27.6% | 25.3% | 26.2% | 27.6% |
| EBIT margin | 11.6% | 11.2% | 11.2% | 8.6% | 10.3% | 10.3% |
| NPM | 10.1% | 9.6% | 9.6% | 6.2% | 8.1% | 8.1% |
| YoY | | | | | | |
| Revenue | 4.3% | -0.6% | -5.3% | 14.8% | 26.5% | 4.9% |
| GP | 6.3% | -1.8% | -13.4% | 0.2% | 19.9% | 14.2% |
| EBIT | -0.4% | 9.3% | -8.0% | -11.7% | 15.7% | 26.1% |
| NP | -0.7% | 4.0% | -10.5% | -26.6% | 6.8% | 38.1% |

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

Table 6: Balance sheet

| US\$ MM, year-end Mar | 2014 | 2015 | 2016 | 2017E | 2018E |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Cash and Cash Equivalents | 644 | 773 | 193 | 163 | 277 |
| Inventories | 207 | 222 | 271 | 280 | 292 |
| Accounts receivable | 442 | 415 | 542 | 560 | 584 |
| Other Current Assets | 14 | 71 | 50 | 87 | 109 |
| Total Current Assets | 1,306 | 1,482 | 1,056 | 1,089 | 1,262 |
| Intangible Assets | 647 | 596 | 1,083 | 1,083 | 1,083 |
| Property and Equipment, Net | 388 | 411 | 667 | 741 | 773 |
| Other Assets | 160 | 360 | 343 | 439 | 466 |
| Non-Current assets | 1,194 | 1,366 | 2,094 | 2,263 | 2,322 |
| Total Assets | 2,501 | 2,848 | 3,149 | 3,352 | 3,585 |
| Accounts Payable | 386 | 381 | 474 | 490 | 511 |
| Other Accrued Expenses | 46 | 36 | 60 | 83 | 108 |
| Taxes Payable | 46 | 37 | 35 | 41 | 48 |
| ST and current LT debts | 115 | 66 | 98 | 100 | 101 |
| Total Current Liabilities | 593 | 521 | 668 | 714 | 768 |
| Long-term Debt | 2 | 226 | 327 | 331 | 335 |
| Other Noncurrent Liability | 0 | 0 | 0 | 0 | 0 |
| Noncurrent liabilities | 2 | 226 | 327 | 331 | 335 |
| Total Liabilities | 734 | 947 | 1,265 | 1,314 | 1,372 |
| Share capital | 6 | 6 | 6 | 6 | 6 |
| Reserves and Surplus | 1,727 | 1,883 | 1,837 | 1,978 | 2,138 |
| Total Shareholders' Equity | 1,732 | 1,862 | 1,843 | 1,984 | 2,144 |
| Minority Interest | 34 | 39 | 42 | 54 | 68 |
| Total Shareholders' Equity | 1,766 | 1,901 | 1,885 | 2,038 | 2,212 |
| Total Liabilities and Equity | 2,501 | 2,848 | 3,149 | 3,352 | 3,585 |

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

Investment Thesis, Valuation and Risks

Johnson Electric Holdings (*Overweight; Price Target: HK\$29.00*)

Investment Thesis

JE is one of the largest makers of motors used in auto and industrial applications. The company is benefiting from a recovery in the auto markets in the US and EU. For industrial motors, JE has a strategy to provide more high-end components with more design work, rather than lower-end “build to print” OEM production.

Valuation

Our Dec-16 PT of HK\$34 is based on a DCF methodology. The nature of the industry leads us to apply a terminal growth rate of 3% (the lower end of the 3-6% growth rate used for SMID-caps) and a risk-free rate of 4.2% (the yield on 10-year government notes in China). We assume a beta of 0.9. Accordingly, WACC is assumed at 9.6%.

Risks to Rating and Price Target

Rising material costs (copper, steel) and wage inflation could crimp margins. The poor economic environment may dampen demand in China. The health of the U.S. auto market may deteriorate after several years of recovery.

Johnson Electric Holdings: Summary of Financials

| Income Statement | | | | | | Cash flow statement | | | | | |
|------------------------------|-------|---------|-------|-------|-------|------------------------------|---------|---------|-------|-------|-------|
| \$ in millions, year end Mar | FY15 | FY16 | FY17E | FY18E | FY19E | \$ in millions, year end Mar | FY15 | FY16 | FY17E | FY18E | FY19E |
| Revenues | 2,136 | 2,236 | 2,566 | 2,678 | 2,740 | EBIT | 243 | 219 | 264 | 295 | 321 |
| % change Y/Y | 1.8% | 4.7% | 14.8% | 4.4% | 2.3% | Depr. & amortization | 70 | 79 | 119 | 128 | 134 |
| Gross Profit | 633 | 589 | 689 | 738 | 774 | Change in working capital | (23) | (24) | (31) | (9) | 11 |
| % change Y/Y | 2.2% | (6.8%) | 16.9% | 7.1% | 4.9% | Taxes | (28) | (29) | (24) | (30) | (37) |
| EBITDA | 313 | 298 | 384 | 423 | 454 | Cash flow from operations | 262 | 245 | 329 | 384 | 428 |
| % change Y/Y | 5.5% | (4.8%) | 28.8% | 10.2% | 7.4% | Capex | (164) | (857) | (289) | (188) | (193) |
| EBIT | 243 | 219 | 264 | 295 | 321 | Net Interest | 8 | (5) | (10) | (10) | (8) |
| % change Y/Y | 4.1% | (9.8%) | 20.6% | 11.4% | 8.8% | Other | 45 | 6 | (5) | (5) | (6) |
| EBIT Margin | 11.4% | 9.8% | 10.3% | 11.0% | 11.7% | Free cash flow | 91 | (609) | 49 | 205 | 242 |
| Net Interest | 8 | (5) | (10) | (10) | (8) | Equity raised/(repaid) | 0 | 0 | 0 | 0 | 0 |
| Earnings before tax | 263 | 207 | 250 | 287 | 315 | Debt raised/(repaid) | 174 | 83 | 5 | 5 | 0 |
| % change Y/Y | 3.7% | (21.5%) | 20.9% | 15.1% | 9.7% | Other | (98) | 0 | 0 | 0 | 0 |
| Tax | (40) | (24) | (30) | (37) | (44) | Dividends paid | (54) | (54) | (62) | (71) | (79) |
| as % of EBT | 15.3% | 11.6% | 12.0% | 13.0% | 14.0% | Beginning cash | 644 | 773 | 193 | 163 | 277 |
| Net income (reported) | 211 | 173 | 208 | 236 | 256 | Ending cash | 773 | 193 | 163 | 277 | 418 |
| % change Y/Y | 1.6% | (18.2%) | 20.3% | 13.7% | 8.4% | DPS | 0.06 | 0.06 | 0.07 | 0.08 | 0.09 |
| Shares outstanding | 902 | 895 | 895 | 895 | 895 | | | | | | |
| EPS (reported) | 0.23 | 0.19 | 0.23 | 0.26 | 0.29 | | | | | | |
| % change Y/Y | 1.6% | (17.5%) | 20.3% | 13.7% | 8.4% | | | | | | |
| | | | | | | | | | | | |
| Balance sheet | | | | | | Ratio Analysis | | | | | |
| \$ in millions, year end Mar | FY15 | FY16 | FY17E | FY18E | FY19E | \$ in millions, year end Mar | FY15 | FY16 | FY17E | FY18E | FY19E |
| Cash and cash equivalents | 773 | 193 | 163 | 277 | 418 | Gross margin | 29.6% | 26.4% | 26.9% | 27.6% | 28.3% |
| Accounts receivable | 415 | 542 | 560 | 584 | 598 | EBITDA margin | 14.6% | 13.3% | 14.9% | 15.8% | 16.6% |
| Inventories | 222 | 271 | 280 | 292 | 299 | Operating margin | 11.4% | 9.8% | 10.3% | 11.0% | 11.7% |
| Others | 71 | 50 | 87 | 109 | 123 | Net margin | 9.9% | 8.3% | 8.4% | 8.8% | 9.3% |
| Current assets | 1,482 | 1,056 | 1,089 | 1,262 | 1,437 | Sales per share growth | 1.8% | 5.5% | 14.8% | 4.4% | 2.3% |
| LT investments | 360 | 343 | 439 | 466 | 494 | Sales growth | 1.8% | 4.7% | 14.8% | 4.4% | 2.3% |
| Net fixed assets | 411 | 667 | 741 | 773 | 804 | Net profit growth | 1.6% | (18.2%) | 20.3% | 13.7% | 8.4% |
| Total Assets | 2,848 | 3,149 | 3,352 | 3,585 | 3,819 | EPS growth | 1.6% | (17.5%) | 20.3% | 13.7% | 8.4% |
| Liabilities | | | | | | Interest coverage (x) | NM | 65.4 | 40.1 | 41.3 | 54.3 |
| Short-term loans | 66 | 98 | 100 | 101 | 101 | Net debt to equity | (25.3%) | 12.3% | 13.2% | 7.2% | 0.7% |
| Payables | 381 | 474 | 490 | 511 | 523 | Working Capital to Sales | 45.0% | 17.3% | 14.6% | 18.5% | 22.8% |
| Others | 73 | 95 | 124 | 156 | 189 | Sales/assets | 0.8 | 0.7 | 0.8 | 0.8 | 0.7 |
| Total current liabilities | 521 | 668 | 714 | 768 | 814 | Assets/equity | 1.5 | 1.6 | 1.7 | 1.7 | 1.7 |
| Long-term debt | 226 | 327 | 331 | 335 | 335 | ROE | 11.7% | 10.0% | 11.3% | 11.4% | 11.5% |
| Other liabilities | 201 | 269 | 269 | 269 | 269 | ROCE | 10.3% | 8.8% | 9.9% | 10.3% | 10.3% |
| Total Liabilities | 947 | 1,265 | 1,314 | 1,372 | 1,418 | | | | | | |
| Shareholders' equity | 1,862 | 1,843 | 1,984 | 2,144 | 2,318 | | | | | | |
| BVPS | 2.09 | 2.10 | 2.26 | 2.44 | 2.64 | | | | | | |

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

JPM Q-Profile

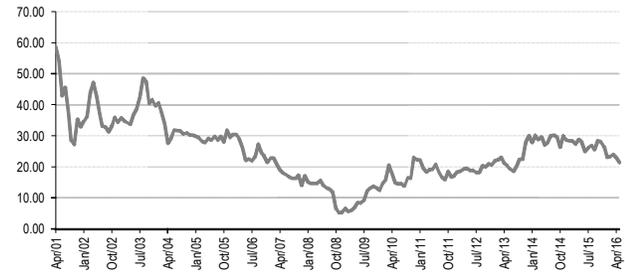
Johnson Electric Holdings Limited (HONG KONG / Industrials)

As Of: 13-May-2016

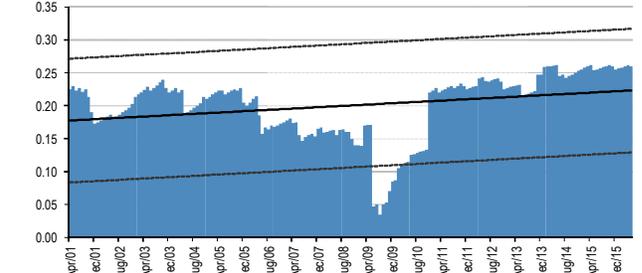
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

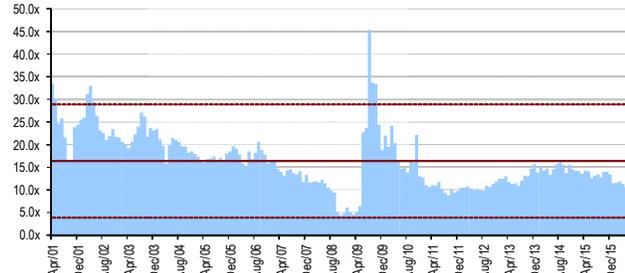
Local Share Price Current: **21.35**



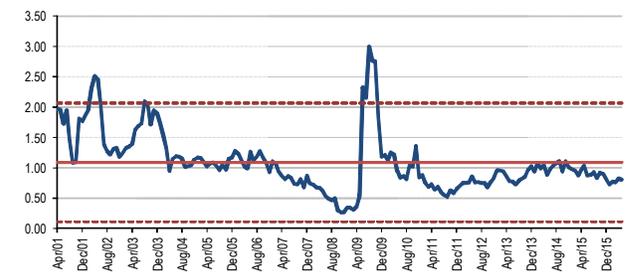
12 Mth Forward EPS Current: **0.26**



PE (1Yr Forward) Current: **10.6x**



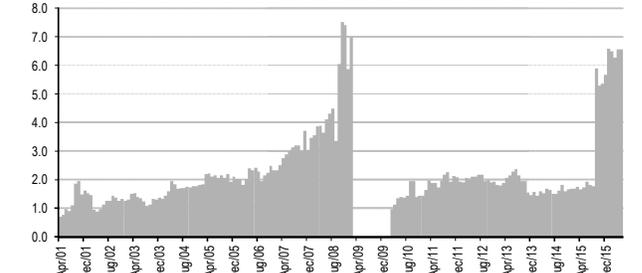
P/E Relative to Hong Kong Index Current: **0.80**



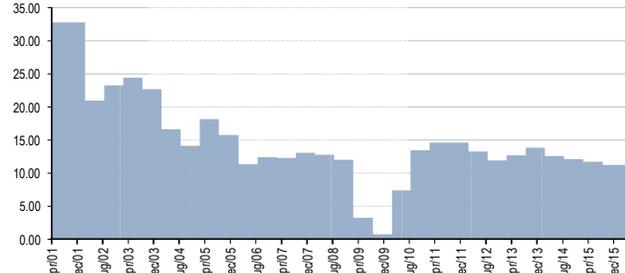
Earnings Yield (& Local Bond Yield) Current: **9.44%**



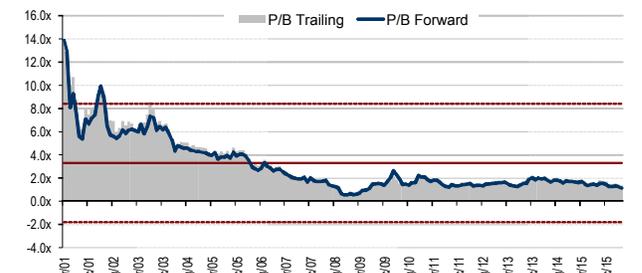
Dividend Yield (Trailing) Current: **6.55**



ROE (Trailing) Current: **11.22**



Price/Book (Value) Current: **1.3x**



Summary

Johnson Electric Holdings Limited

HONG KONG

Industrials

TICKER 179 HK

As Of: 13-May-16

Local Price: 21.35

EPS: 0.26

| | Latest | Min | Max | Median | Average | 2 S.D.+ | 2 S.D. - | % to Min | % to Max | % to Med | % to Avg |
|---------------------------|--------|------|-------|--------|---------|---------|----------|----------|----------|----------|----------|
| 12mth Forward PE | 10.60x | 4.44 | 45.27 | 15.16 | 16.37 | 28.88 | 3.86 | -58% | 327% | 43% | 54% |
| P/BV (Trailing) | 1.35x | 0.58 | 13.76 | 1.91 | 3.29 | 8.42 | -1.83 | -57% | 919% | 42% | 144% |
| Dividend Yield (Trailing) | 6.55 | 0.00 | 7.51 | 1.86 | 2.14 | 5.07 | -0.78 | -100% | 15% | -72% | -67% |
| ROE (Trailing) | 11.22 | 0.81 | 32.79 | 13.06 | 14.81 | 28.22 | 1.39 | -93% | 192% | 16% | 32% |

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

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Johnson Electric Holdings (0179.HK, 179 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 09, 2007.

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