

Company Report: Harbin Electric (01133 HK)

公司报告: 哈尔滨电气 (01133 HK)

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More Reforms to Take Place, Maintain "Accumulate"

更多的改革预计将被启动, 维持“收集”

- **Earnings in 1H2018 fell YoY by 75.3%, in line with profit warning.** Sales, gross profit and net profit in 1H2018 dropped YoY by 24.1%, 28.1% and 75.3%, respectively. The sharp decline in net profit was mainly due to reduced sales and gross margin decline. Company gross margin was down YoY by 0.7 ppt to 11.9% in 1H2018 as gross margin in key business segments dropped. Overseas sales contributed 29.9% of total sales and reached RMB 3.8 bn, down YoY by 42.8%.
- **More reforms are expected to take place to revive Harbin Electric.** The profit decline in recent years was mainly due to thermal downtrend in the domestic market. We expect more reforms and corporate transformation to take place in order to reverse the current downtrend of Harbin Electric.
- **Earnings forecasts were adjusted following the disappointing interim results.** We expect sales to drop 22% in 2018 but to remain stable in 2019 and 2020. Gross margin is estimated to be 13.7%/ 13.9%/ 14.1% in 2018 to 2020, respectively. Our revised EPS forecasts from FY18 to FY20 are RMB 0.071/ RMB 0.109/ RMB 0.120, respectively.
- **We maintain our "Accumulate" investment rating but cut the TP to HK\$ 3.00.** The new TP corresponds to 0.3x FY18/ FY19 PBR.
- **2018 上半年净利同比下滑 75.3%，与盈利警告一致。** 2018 上半年的收入，毛利及净利分别同比下降 24.1%，28.1% 及 75.3%。导致期内盈利下挫的主要原因是收入减少以及毛利率的下降。期内毛利率同比跌 0.7 个百分点至 11.9%，主要因为核心业务板块的毛利率出现下降。海外收入贡献了期内 29.9% 的收入并达到了人民币 38 亿，同比下降 42.8%。
- **我们预计更多的改革将被推出以振兴哈尔滨电气。** 近年来的盈利下降主要受国内的火电下行所影响。我们预计公司转型以及更多的改革将被启动，以扭转公司的下行趋势。
- **在令人失望的中期业绩之后，我们调整了盈利预测。** 我们预计公司的收入将于 2018 年同比下滑 22%，但将在 2019 年和 2020 年维持稳定。毛利率预计将在 2018 至 2020 年间分别达到 13.7% / 13.9% / 14.1%。我们经调整后的 2018 至 2020 年的每股净利分别为人民币 0.071，人民币 0.109 以及人民币 0.120。
- **我们下调公司的目标价至 3.00 港元但维持“收集”的投资评级。** 我们的新目标价相当于 0.3 倍 2018 年/2019 年市净率。

Rating:

Accumulate

Maintained

评级:

收集 (维持)

6-18m TP 目标价:

HK\$3.00

Revised from 原目标价:

HK\$4.00

Share price 股价:

HK\$2.270

Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	(14.5)	(10.8)	(44.7)
Rel. % to HS Index 相对恒指变动 %	(11.8)	0.5	(41.9)
Avg. share price(HK\$) 平均股价 (港元)	2.48	2.43	2.93

Source: Bloomberg, Guotai Junan International.

Year End 年结 12/31	Turnover 收入 (RMB m)	Net Profit 股东净利 (RMB m)	EPS 每股净利 (RMB)	EPS 每股净利变动 (Δ %)	PER 市盈率 (x)	BPS 每股净资产 (RMB)	PBR 市净率 (x)	DPS 每股股息 (RMB)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2016A	30,929	413	0.300	109.8	6.8	9.757	0.2	0.030	1.5	3.2
2017A	31,540	194	0.114	(62.0)	16.6	8.714	0.2	0.015	0.8	1.4
2018F	24,464	122	0.071	(37.7)	27.5	8.842	0.2	0.009	0.5	0.8
2019F	24,535	186	0.109	53.5	17.9	8.980	0.2	0.013	0.7	1.2
2020F	24,904	204	0.120	10.1	16.3	9.090	0.2	0.014	0.7	1.3

Shares in issue (m) 总股数 (m)	1,706.5	Major shareholder 大股东	Harbin Electric Group	60.4%
Market cap. (HK\$ m) 市值 (HK\$ m)	3,873.8	Free float (%) 自由流通比率 (%)		36.1
3 month average vol. 3 个月平均成交股数 ('000)	1,739.0	FY18 Net gearing (%) FY18 净负债/股东资金 (%)		Net Cash
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)	4.090 / 2.170			

Source: the Company, Guotai Junan International.

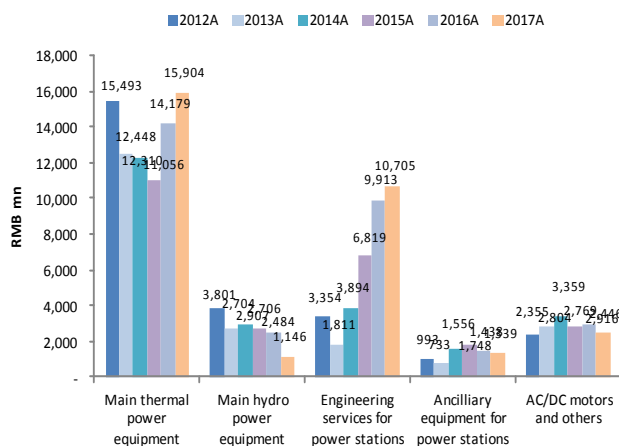
Net earnings in 1H2018 dropped YoY by 75.3% to RMB 31 mn, worse than expectation. Harbin Electric's (the "Company") operating results during the first 6 months were worse than expectations but in line with the Company's prior issued profit warning. Sales and net profit in 1H2018 went down YoY by 24.1% and 75.3%, respectively. The sales of the Company in 1H2018 experienced a sharp drop mainly as revenues from thermal power equipment and power engineering services continued to fall during the reporting period. Sales of thermal equipment dropped 9.1% YoY to RMB 6.25 bn and that of power engineering services fell YoY by 43.3% to RMB 3.81 bn. The two contributed roughly 80% of Harbin Electric's total sales in 1H2018 and caused direct impact to the Company's revenues decline during the period. Hydro equipment sales and AC/ DC motor sales recorded YoY growth rates of 26.8% and 3.5%, respectively, during the period, but the two business segments couldn't reverse the declining trend of the Company. Total capacity of power equipment produced in 1H2018 amounted to 7.6 GW, down YoY by 18.3%, mainly due to the decrease in demand from the domestic market. Except for the gross margin recovery of power plant auxiliary products and of AC/ DC motors, all other segments experienced gross margin decline in 1H2018. As a result, the Company gross margin dropped YoY by 0.7 ppt to 11.9%. Net margin was down 0.5 ppt to 0.2%. Asset impairment loss was down 46.4% to RMB 320 mn and was not the key cause of earnings reduction. Overseas sales contributed 29.9% of overall sales and amounted to RMB 3.8 bn, down YoY by 42.8%. The decrease in domestic demand on conventional power equipment as a result of energy structure optimization has negatively impacted the Company and is expected to continue to influence profitability going forward. As such, we expect industry consolidation to accelerate and deep reforms to take place over next 12 months. The Company maintained net cash position of RMB 7.7 bn at the end of the reporting period, and could leverage its resources to transform itself by acquiring new assets should a merger with its peers be unlikely.

Table-1: Harbin Electric's 1H2018 Operating Results and YoY Comparison

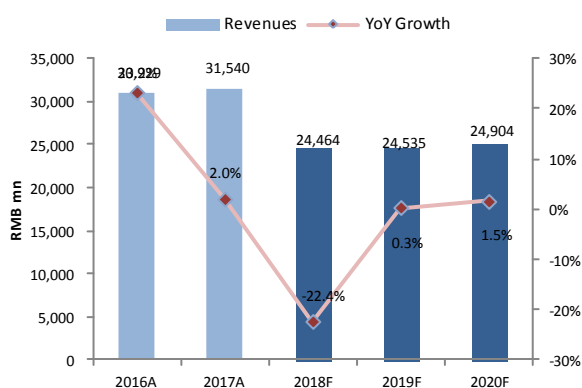
(RMB mn)	1H2018	1H2017	YoY Δ	Comments
Revenues	12,731.936	16,778.045	-24.1%	Due to the sales decline in thermal equipment and engineering services
COGS	(11,216.344)	(14,668.840)	-23.5%	
Gross profit	1,515.593	2,109.205	-28.1%	GM was down by 0.7 ppt to 11.9%
Other income	293.411	238.060	+23.3%	
Distribution expense	(237.365)	(246.380)	-3.7%	
Administrative expense	(895.566)	(935.419)	-4.3%	
Other operating expense	(427.730)	(687.289)	-37.8%	Asset impairment loss went down YoY by 46.4% to RMB 320 mn
EBIT (Operating income)	248.343	478.177	-48.1%	
Non-operating income / (loss)	(38.354)	(85.371)	-55.1%	
Finance cost	(65.223)	(168.742)	-61.3%	
Profit before tax	144.767	224.064	-35.4%	
Income tax	(78.534)	(75.966)	+3.4%	
Minority interest	(35.464)	(23.504)	+50.9%	
Net income to shareholders	30.769	124.594	-75.3%	
EPS	0.018	0.090	-80.1%	
Margins (YoY comparison)				YoY ppt Δ
Gross margin	11.9%	12.6%	-0.7 ppt	Gross margin of key business segments dropped
EBIT margin	2.0%	2.9%	-0.9 ppt	
PBT margin	1.1%	1.3%	-0.2 ppt	
Net margin	0.2%	0.7%	-0.5 ppt	

Source: the Company, Guotai Junan International.

New contracts signed went down sharply due to a significant drop in overseas new orders. New contracts signed in the first 6 months of 2018 reached RMB 8.65 bn, down YoY by 27.8%. Among which, thermal, hydro, nuclear and power plant services contributed 41.8%, 20.8%, 5.3% and 12.2% of new contracts signed, respectively. Overseas new orders contributed RMB 243 mn during the period, down YoY by 86.2%. The sharp drop in overseas orders was the key cause of the new orders decline during the first 6 months. Since the overseas strategy is not working well to get the Company out of the difficulty, we expect that further reforms are needed for a turnaround and improve the profitability of Harbin Electric. Conventional power equipment orders are expected to further drop as demand in domestic market is set to shrink going forward, especially thermal power and hydro power equipment orders. The Company would need to add new business segments to its portfolio before its new orders will surge again in the future.

Figure-1: Revenues by Segment – Harbin Electric


Source: the Company, Guotai Junan International.

Figure-2: Historical & Forecast Sales – Harbin Electric


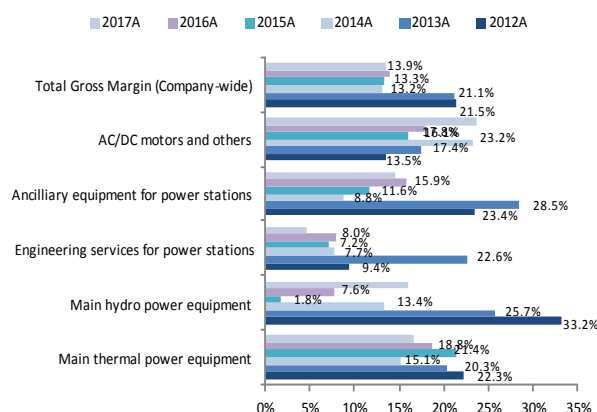
Source: the Company, Guotai Junan International.

More reforms are expected to take place to revive the Company. We expect that domestic demand on conventional power equipment will continue to shrink and therefore more reforms are expected to take place to save state owned enterprises in the power equipment sector from falling. We believe that the thermal sector and power equipment sector are very likely to benefit from the reforms aiming to reverse their declining trend. The rise in the electricity price as well as the increase in utilization hours are the answer to the earnings rise amongst thermal power producers in China in 1H2018; both are direct results of government policy. We expect that Harbin Electric will be a key beneficiary of power equipment sector reforms. We expect the Company to adopt more stringent measures to control its operating expenses via consolidation of resources, and continue to develop advanced power equipment with cutting edge technology that meets the new environmental protection standards in China. Supply-side reform on power equipment will be realized via mergers between competitors within the industry or via forced shutdown of outdated production capacities. The likelihood of a merger remains high as the Chinese government re-emphasized the need to restructure and merge state-owned enterprises currently suffering from overcapacity. Should a merger fail to take place, we believe it will be replaced by corporate transformation, meaning that the Company may enter into new businesses either via joint ventures or via M&As. The transformation will diversify Harbin Electric but it will take some time before positive results will start coming out.

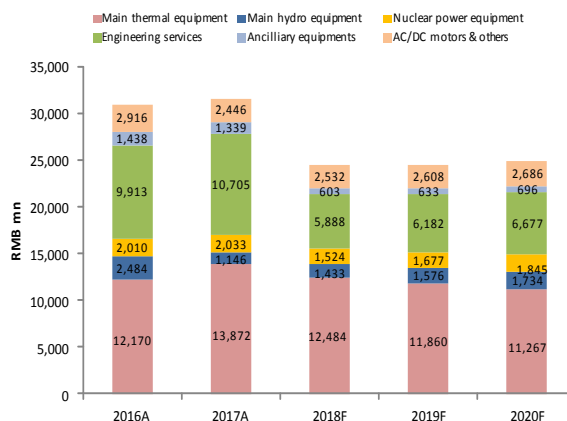
Power generating infrastructure investment in China in 7M2018 reached RMB 123.8 bn, down YoY by 1.3%. According to CEC, nationwide newly installed power generating capacity in 7M2018 reached 66.6 GW, down YoY by 3.2% or YoY decrement of 2.2 GW. Thermal, hydro, nuclear, wind and solar contributed 18.8 GW, 4.8 GW, 2.2 GW, 9.5 GW and 31.3 GW, respectively, of newly installed capacity in 7M2018. Wind and nuclear power new installations went up YoY by 29.6% and 103.5%, respectively, while thermal, hydro and solar new installations went down YoY by 0.2%, 28.4% and 10.5%, respectively. Nationwide power generating infrastructure investment in 7M2018 reached RMB 123.8 bn, down YoY by 1.3%. Thermal, hydro, nuclear and wind power investment in 7M2018 went up YoY by 1.9%, 17.8%, 11.2% and down YoY by 4.9%, respectively. During the first 7 months in 2018, renewable energies such as hydro, nuclear and wind power contributed 69.2% of power generating infrastructure investment in China. Meanwhile, nationwide power grid investment reached RMB 234.7 bn in 7M2018, down YoY by 16.6%. Power generating infrastructure investment remained stable while investment on power grid continued to decline in the first 7 months. About 70% of the power generating infrastructure investment in China in 7M2018 was spent on renewable energies, and we believe the investment in renewable energies will continue to dominate power investment in China going forward.

We have trimmed our earnings estimates based on disappointing 2018 interim results. We believe that demand for conventional power equipment will remain sluggish over the next few years as renewable energy is currently the focus of China. We expect sales of Harbin Electric to fall in 2018 but to remain stable in 2019 and 2020. With expected segmental margin recovery, gross margin is estimated to be 13.7%/ 13.9%/ 14.1% from 2018 to 2020, respectively. Furthermore, we expect operating expenses to be controlled at a low level with no dramatic rise in asset impairment loss during the period. As the SOE reforms and corporate transformation are quite uncertain at this point, we haven't factored in the impact to the financials of Harbin Electric. We have revised our earnings forecasts based on our new assumptions. Our revised EPS forecasts from FY18 to FY20 are RMB 0.071, RMB 0.109 and RMB 0.120, respectively.

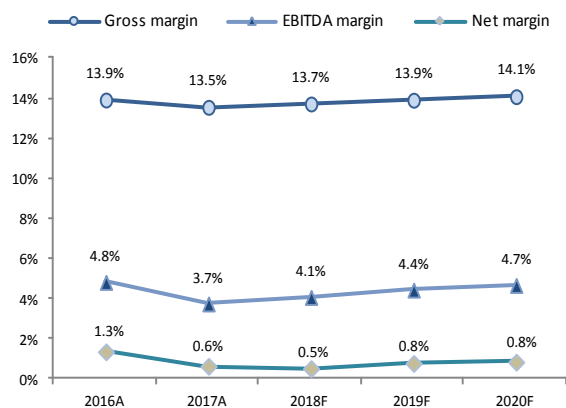
Maintain the "Accumulate" investment rating but cut the TP to HK\$ 3.00. The profitability of Harbin Electric is expected to gradually improve under more stringent cost control measures. However, the Company is still exposed to the risk of a sharp rise in asset impairment loss and the further drop in revenues due to thermal downtrend in the China market. Key catalysts for Harbin Electric are the 1) announcement of structural reform policies in the industry, 2) a merger with its peer within the power equipment industry, 3) share buyback, and 4) corporate transformation via M&As. We believe that more reforms are set to come out to help revive Harbin Electric. We therefore maintain our "Accumulate" investment rating but cut the TP to HK\$ 3.00. The new TP corresponds to 23.7 FY19 PER or 0.3x FY18/ FY19 PBR.

Figure-3: Gross Margin by Segment – Harbin Electric


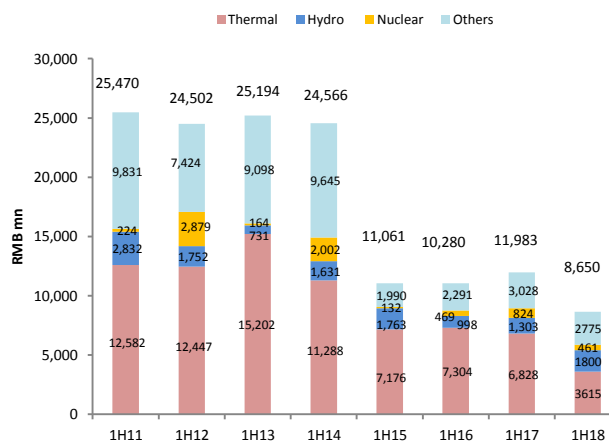
Source: the Company, Guotai Junan International.

Figure-4: Forecast Sales by Segment – Harbin Electric


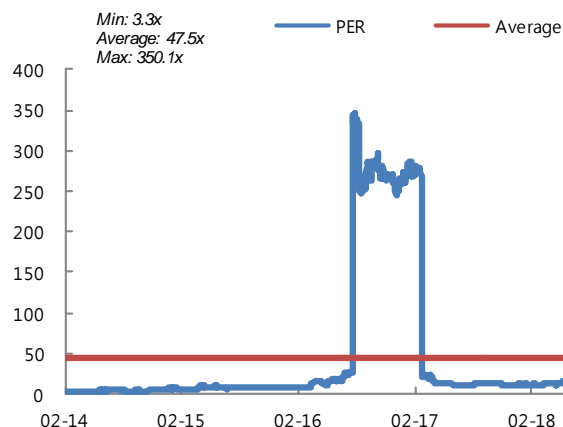
Source: the Company, Guotai Junan International.

Figure-5: Margin Analysis – Harbin Electric


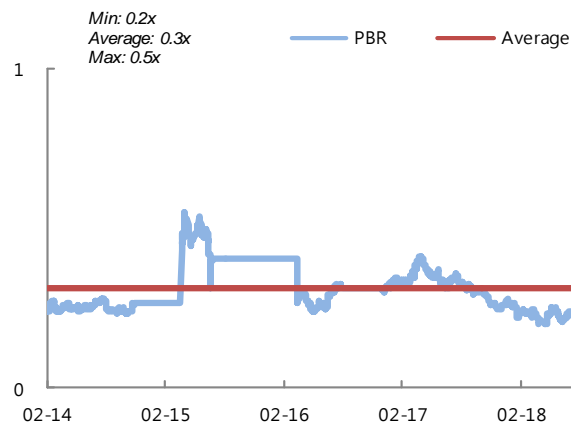
Source: the Company, Guotai Junan International.

Figure-6: Historical New Orders


Source: the Company, Guotai Junan International.

Figure-7: Forward PER of Harbin Electric


Source: Bloomberg, Guotai Junan International.

Figure-8: Forward PBR of Harbin Electric


Source: Bloomberg, Guotai Junan International.

Table-2: Peers Comparison

Company	Stock Code	Currency	Last price (in local \$)	PE (fiscal year)				PB (fiscal year)				ROE (%)	D/Y (%)	Market Cap
				17A	18F	19F	20F	17A	18F	19F	20F			
HK - Listed Peers														
Dongfang Electric Corp - H	01072 HK	HKD	4.34	13.0	10.7	10.0	9.9	0.4	0.5	0.4	0.4	4.1	1.0	25,451
Harbin Electric	01133 HK	HKD	2.27	13.9	23.8	13.7	13.3	0.2	0.2	0.2	0.2	3.7	1.0	3,874
Shanghai Electric - H	02727 HK	HKD	2.50	11.6	13.0	13.2	12.1	0.6	0.6	0.6	0.5	4.5	3.4	76,976
Simple Average				12.8	15.8	12.3	11.8	0.4	0.4	0.4	0.4	4.1	1.8	
Weighted Average				12.0	12.7	12.4	11.6	0.5	0.5	0.5	0.5	4.4	2.7	
Offshore - Listed Peers														
Alstom	ALO FP	EUR	39.69	30.1	18.5	19.1	18.9	2.4	2.2	2.4	2.3	12.5	0.7	80,982
Bharat Heavy Electricals	BHEL IN	INR	75.10	n.a.	n.a.	22.4	17.7	0.9	0.9	0.8	0.8	1.4	1.9	30,218
Doosan Heavy Industries	034020 KS	KRW	14,950.00	n.a.	24.7	9.0	6.7	0.5	0.5	0.5	0.5	2.6	0.0	12,276
General Electric	GE US	USD	12.71	n.a.	13.6	12.2	10.8	1.7	2.6	2.9	2.7	12.8	3.8	866,930
Hyundai Heavy Industries	009540 KS	KRW	127,500.00	2.8	n.a.	66.0	24.2	0.6	0.7	0.7	0.7	(1.8)	0.2	61,814
Mitsubishi Heavy Industries	7011 JT	JPY	4,080.00	15.6	19.4	16.6	12.7	0.8	0.8	0.8	0.7	3.9	2.9	96,416
Siemens Ag	SIE GY	EUR	109.30	14.7	14.9	14.0	12.4	2.1	1.9	1.8	1.7	13.1	3.5	852,496
Wartsila Oyj Abp	WRT1V FH	EUR	16.63	25.6	19.6	16.4	14.8	4.2	3.9	3.5	3.1	20.2	2.9	90,295
Simple Average				17.8	18.5	22.0	14.8	1.6	1.7	1.7	1.6	8.1	2.0	
Weighted Average				16.0	15.0	15.3	12.5	1.9	2.2	2.3	2.1	12.1	3.3	

 Source: Bloomberg, Guotai Junan International. Prices are as of 14th September 2018.

Financial Statements and Ratios

Income Statement					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Total Revenue	30,929	31,540	24,464	24,535	24,904
COGS	(26,627)	(27,268)	(21,109)	(21,125)	(21,398)
Gross profit	4,303	4,272	3,355	3,411	3,506
Selling expense	(638)	(639)	(563)	(589)	(610)
Admin expense	(2,137)	(2,254)	(2,055)	(2,036)	(2,079)
Other gains / expenses	(554)	(733)	(297)	(280)	(265)
Operating Profit	973	646	441	505	551
Non operating income / (expense)	(44)	(87)	(57)	(61)	(66)
Share of JV / affiliate	2	26	30	35	40
Net finance costs	(274)	(242)	(149)	(121)	(131)
Profit Before Tax	657	343	265	358	394
Income Tax	(166)	(82)	(66)	(89)	(99)
Profit After Tax	492	261	199	268	296
Non-controlling Interest	(78)	(67)	(77)	(83)	(91)
Shareholders' Profit / Loss	413	194	122	186	204
Basic EPS (RMB)	0.300	0.114	0.071	0.109	0.120
DPS (RMB)	0.030	0.015	0.009	0.013	0.014

Cash Flow Statement					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Net income	413	194	122	186	204
D&A	512	530	551	578	607
Change in working capital	(562)	830	(1,552)	(1,446)	(1,525)
Others	1,225	(4,246)	(1,056)	(1,160)	(1,041)
Cash from Operating Activities	1,588	(2,692)	(1,936)	(1,842)	(1,755)
Investing activities					
Capital expenditure	(1,124)	(881)	(612)	(564)	(498)
Proceeds from disposal	1	(7)	7	7	7
Others	833	(621)	(132)	(139)	(147)
Cash from Investing Activities	(290)	(1,509)	(737)	(697)	(638)
Financing activities					
Stock issuance	0	1,269	0	0	0
Debt raised / (repaid)	(298)	(540)	(612)	303	34
Dividend	(21)	(41)	(26)	(15)	(22)
Others	(1,010)	1,606	1,365	1,486	1,337
Cash from Financing Activities	(1,329)	2,294	727	1,774	1,349
Net Changes in Cash	(31)	(1,908)	(1,945)	(765)	(1,044)
Adjustments	(116)	(17)	0	0	0
Cash at Beg of Year	18,237	18,090	16,165	14,220	13,455
Cash at End of Year	18,090	16,165	14,220	13,455	12,411

Source: the Company, Guotai Junan International.

Balance Sheet					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
PPE	6,666	6,825	6,927	6,960	6,898
Interest in associates	214	203	227	254	285
Intangibles & goodwill	650	772	795	813	833
Other non-current assets	719	1,020	1,060	1,106	1,156
Total Non-current Assets	8,249	8,819	9,010	9,134	9,171
Cash & Cash Equivalents	18,090	16,165	14,220	13,455	12,411
Inventories	16,424	15,546	12,032	12,041	12,432
Trade receivable	13,867	14,951	14,678	14,721	15,191
Other current assets	9,237	9,356	8,893	9,439	10,280
Total Current Assets	57,618	56,019	49,823	49,656	50,314
Total Assets	65,868	64,838	58,832	58,790	59,485
Short-term debts	2,089	3,084	1,368	1,571	1,485
Trade payable	18,327	19,532	16,887	15,843	15,620
Deposits & placements from financial institutions	2,674	803	1,606	1,606	1,606
Others	23,706	23,657	20,499	20,695	21,095
Total Current Liabilities	46,797	47,076	40,361	39,716	39,806
Long-term debts	0	200	500	600	720
Corporate bond	2,998	0	0	0	0
Others	1,430	1,420	1,534	1,718	1,924
Total Non-current Liabilities	4,428	1,620	2,034	2,318	2,644
Total Liabilities	51,225	48,696	42,395	42,034	42,450
Total Shareholders' Equity	13,433	14,871	15,090	15,325	15,512
Minority Interest	1,209	1,271	1,348	1,431	1,522
Total Equity	14,642	16,142	16,438	16,756	17,035
BPS (RMB)	9.757	8.714	8.842	8.980	9.090

Financial Ratios					
	2016A	2017A	2018F	2019F	2020F
Gross margin	13.9%	13.5%	13.7%	13.9%	14.1%
EBIT margin	3.1%	2.0%	1.8%	2.1%	2.2%
EBITDA margin	4.8%	3.7%	4.1%	4.4%	4.7%
Net margin	1.3%	0.6%	0.5%	0.8%	0.8%
ROE	3.2%	1.4%	0.8%	1.2%	1.3%
ROA	0.6%	0.3%	0.2%	0.3%	0.3%
Net gearing	Net cash	Net cash	Net cash	Net cash	Net cash
Inventory turnover(day)	215.8	211.0	205.2	205.2	209.2
AR turnover (day)	158.1	164.5	216.0	216.0	219.6
AP turnover (day)	246.2	249.9	288.0	270.0	262.8
EV/EBITDA (x)	-5.6	-7.0	-7.6	-5.9	-4.5
Quick ratio (x)	0.7	0.7	0.7	0.7	0.7
Current ratio (x)	1.2	1.2	1.2	1.3	1.3

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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