

Combo railway and energy logistics play

China Software

CH Automation (569 HK)

Not Rated

Leading safety and critical control systems provider in China. Founded in 1999, China Automation Group Ltd (China Auto) provides safety and critical control systems to China's oil and gas, petrochemical, chemical, and railway industries. The company derives its revenues from five main segments: (1) engineering & maintenance services; (2) trading of equipment; (3) railway interlocking system (RIS); (4) emergency shutdown devices (ESD) and fire and gas systems (FGS) and (5) integrated turbine and compressor controls (ITCC). In FY12/06A, ITCC accounted for 39.0% of its total revenue; ESD & FGS for 23.0% engineering & maintenance services for 16.0% IS for 13.5%, and trading of equipment for 8.5%.

Table 1: Offer statistics

No. of shares offered (greenshoe option: 15%)	200.0m
Fund raised	HK\$238.0-306.0m
Price range	HK\$1.19-1.53
Offer P/E (FY12/06A F.D.)	14.0-18.0x
FY12/05A EPS – Basic	HK\$0.057
FY12/06A EPS – Basic	HK\$0.086
Market cap.	US\$121.9-156.7m
IPO open	28-Jun.
IPO close	4-Jul.
Listing	12-Jul.

Source: Company data

Total solution with a focus on software. China Auto develops its own software and bundles it into a total solution featuring Triconex hardware and other components. It has self-developed eight software systems and has been an exclusive distributor for Triconex products in China. Triconex is a brand of global industrial automation controls and transportation software provider Invensys. China Auto has also set up five liaison centers in China, which cover all provinces except Guizhou. They provide engineering system upgrades, system checkpoint services, on-call and on-site support and system diagnostics and valuation services.

Well known clients. Its clients are mainly well-known Chinese companies in oil and gas, petrochemical, chemical and railway industries, such as Petrochina (857 HK), China Petroleum & Chemical (386 HK) and China Shenhua Energy (1088 HK). According a survey by Frost & Sullivan, China Auto has 68.0% of China's safety and critical control system market and it expect the ratio to reach 71.0-72.0% in the next two years.

Multi-faceted growth drivers. Growth drivers include: 1) China's booming oil and gas, chemical and petrochemical industries; 2) rapid development of high-speed railway and expected big investment in railway construction and 3) government's emphasis on industrial safety, particularly in oil and gas, chemical and petrochemical industries. According to Frost & Sullivan, in 2006-2010, the CAGR of China's ESD market is estimated at 34.7%, ITCC 23.8% and FGS 90.6%. The total market size is estimated at US\$190.0m in 2010.

Upside from M&As and maintenance services. China Auto will be looking to M&As of related vertical and horizontal parts of the value chain, as well as increased contribution of maintenance services to drive growth. Maintenance services increased at a three-year CAGR of 142.8% and we expect an increasing installed base going forward to continue to support this robust growth.

Strong revenue and margin growth. The company's revenue grew at an average of 32.2% from 2004 to 2006. The largest increase came from engineering and maintenance services, up at a three-year CAGR of 142.8%. RIS,

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ITCC and ESD&FGS grew 109.3%, 35.2% and 9.0%, respectively, in the period. Trading of equipment fell at a 10.8% three-year CAGR, due to a one-off contract in 2005. China Auto's gross margin widened from 36.9% in FY12/04A to 42.9% in FY12/06A. FY12/06A net profit was RMB68.5m.

Overseas expansion. China Auto set up an office in Singapore in 2006 to tap the Southeast Asian market. It also plans to set up offices in Dubai and Canada.

Key risk - relationship with Triconex. Changes in its relationship with Invensys could greatly affect China Auto's performance because its software is sold with Triconex hardware, which is very popular in China. The company signed an exclusive three-year contract with Invensys in 2006 to distribute Triconex products in China.

Table 2: Use of proceeds

	HK\$m	%
R&D Expenditure	40.0	16.0
Constructing R&D center and production facilities	40.0	16.0
Expanding sales network	30.0	12.0
Expanding services network	25.0	10.0
Office in Dubai and Canada	30.0	12.0
Acquisition	60.0	24.0
General working capital	24.5	10.0
Total	249.5	100.0

Source: Company data

Table 3: Turnover breakdown

Year end Dec (RMBm)	04A	05A	06A
Turnover			
Engineering & Maintenance Services	7.8	26.2	46.0
Trading of Equipment	30.9	54.2	24.6
RIS	8.9	34.2	39.0
ESD & FGS	56.1	60.3	66.6
ITCC	61.7	89.5	112.8
Total	165.4	264.4	289.0

Source: Company data

Table 4: Financial highlights

Year end Dec (RMBm)	04A	05A	06A
Turnover	165.4	264.4	289.0
Gross profit	61.1	86.7	124.1
Net profit	35.2	45.3	68.5

Source: Company data

Table 5: Margin trend

Year end Dec (%)	04A	05A	06A
Gross	36.9	32.8	42.9
Net	21.1	17.1	23.7

Source: Company data, SBI E2-Capital

Table 6: Key ratios

Year end Dec	04A	05A	06A	Pro Forma 06A
Inventory days	130.0	105.0	111.0	111.0
Receivable days	94.0	94.0	138.0	138.0
Payables days	82.0	71.0	75.0	75.0
Current ratio (x)	1.7	2.1	1.8	1.8
Gearing (%)	Cash	Cash	Cash	Cash
ROE (%)	47.2	38.5	46.3	17.2
Debt/equity (%)	112.1	81.2	93.9	34.8
Interest coverage (x)	72.0	120.0	30.0	30.0

Source: Company data, SBI E2-Capital

Investment Highlights

- ❑ Well positioned to simultaneously tap the growth of China's railway and oil and gas.
- ❑ Ready to capitalize on China's increasing demand for safety and critical control systems; replacement and upgrade of old systems - driven by increasing market growth and higher safety requirement.
- ❑ Market leader with an asset-light model, different from other plays associated with these sectors.
- ❑ Growing maintenance and services contribution.

Valuation.

China Auto has not provided a profit forecast for FY12/07F. The offer price of HK\$1.19-1.53 represents a historical FY12/06A P/E of 14.0-18.0x on a fully diluted basis, which is lower than the historical valuation traded by comparable peers (30.6x historical P/E). Zhuzhou CSR (3898 HK) IPO was at an offering valuation of 11.0-15.0x FY12/06F P/E in Dec 06.

Table 7: Peer comparison

Stock	Ticker	Currency	Share price	Market cap (US\$m)	P/E (x) historical	Operating margin (%)	ROA (%)	ROE (%)
Global peers								
Invensys Plc.	ISYS LN	GBP	388.5	6,072.3	52.1	9.5	9.8	21.2
Honeywell International	HON US	USD	56.6	43,960.5	18.1	9.8	6.7	20.3
Woodward Governor Co.	WGOV US	USD	58.0	1,923.4	23.4	9.8	9.7	15.3
Siemens AG-REG	SIE GR	EUR	107.0	127,703.5	27.9	3.7	3.4	10.8
Yokogawa Electric Corp.	6841 JP	JPY	1676.0	3,654.9	88.0	4.4	1.5	2.4
<i>Average</i>					41.9	6.9	8.1	51.7
China peers								
Enric Energy Equipment	3899 HK	HKD	7.5	429.3	33.7	15.5	11.9	21.2
China Fire Safety Enterprise	8201 HK	HKD	0.6	219.3	13.8	17.7	9.0	11.8
ZZnode Tech Co Ltd	2371 HK	HKD	0.7	34.4	21.5	9.1	6.0	7.4
<i>Average</i>					23	14.1	8.9	13.5
Oil and gas facility providers								
Anhui Tianda oil pipe Co.	8241 HK	HKD	7.9	506.8	22.4	15.4	13.6	20.6
Shangdong Molong Petroleum	568 HK	HKD	1.7	696.7	38.1	16.9	11.6	29.7
Jutai offshore oil services	3303 HK	HKD	2.8	146.1	20.6	17.8	18.8	25.5
Emer International Group Ltd.	8149 HK	HKD	2.9	121.1	24.3		19.3	28.6
<i>Average</i>					26.4		15.8	26.1
Railway facility providers								
Zhuzhou CSR times electric	3898 HK	HKD	13.6	1,959.6	31.3	23.0	11.3	17.1
<i>Average</i>					30.6		10.6	17.2

Source: Bloomberg, SBI E2-Capital