

# China High Speed Trans.



## Wind in the sails

### Key points:

- Robust guidance from leading wind turbine manufacturers despite the current global economic slowdown
- We believe the momentum of alternative energy investment will pick up under the newly elected US government
- Aim to reduce reliance on fossil fuels and greenhouse gas emissions
- Worldwide installed wind capacity to grow at CAGR 25% in 2007A-2012F
- CHST is leading supplier of much-in-demand wind turbine gear boxes
- The company is well positioned to capitalize on the supply chain's increasing migration to China with its technology competency and price competitiveness
- Trading at 12.4x FY12/08F and 8.7x FY12/09F P/E based on consensus estimates

**Strong outlook.** The outlook of global key turbine manufacturers remains positive as confirmed by their most recent quarterly results (see Table 1). Key themes include:

- ❑ Sustained investment despite challenging economic times;
- ❑ Strong order book growth;
- ❑ Earnings visibility well into 2009 (into 2015 for REPower);
- ❑ Falling commodity prices to provide some relief for the supply chain;
- ❑ Tight supply of key components such as bearings, gear boxes and rotary blades;
- ❑ Strong sovereign support to help limit the impact of the global economic crisis. Only isolated project delays (eg. BP's JV with Goldwind);
- ❑ Economic crisis to narrow the demand and supply gap;
- ❑ Negatives: 1) reduced credit to small projects in the medium term; 2) increased financing costs in the short term.

**Not just about the oil price.** We believe wind power investment will remain healthy despite adverse macroeconomic factors (slowing global economy, falling oil prices and tightened credit) because:

Energy diversification drive – reducing reliance on fossil fuels

Efforts to reduce CO2 emissions – to reach targets under the Kyoto Protocol

Strong sovereign support – direct investment and favourable policies

**Not Rated**

### China Alternative Energy

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### Stock data

Price	HK\$5.98
Target price	n/a
12 mth range	HK\$4.44-24.8
Market cap.	US\$955.1m
Daily t/o, 3 mth	US\$9.2m
Free float %	56.7%
Ticker	0658.HK/658 HK

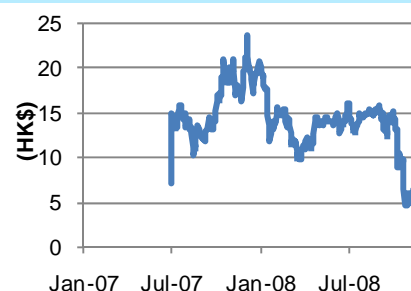
### Financial summary

Year to Dec	05A	06A	07A
Turnover (RMBm)	946.7	1,184.3	1,904.8
Net Profit (RMBm)	81.8	85.6	306.7
EPS (HK\$m)	0.134	0.140	0.288
EPS Δ%	116.4	4.8	104.9
P/E (x)	39.1	37.4	18.2
P/B (x)	24.7	6.2	2.1
EV/EBITDA (x)	17.0	15.9	13.3
Yield (%)	-	2.6	0.6
ROE (%)	61.1	25.9	16.9
ROCE (%)	18.2	12.6	12.4
N. Gear. (%)	184.4	95.7	Cash

### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+3.4	-38.5	-35.1
Actual price changes (%)	+27.2	-61.2	-67.7
	08F	09F	10F
Consensus EPS (RMB)	0.426	0.604	0.769
Previous forecasts (RMB)	-	-	-
Previous EPS (RMB)	-	-	-

### Price Chart



**Obama towing the environmental line.** A recent UN report said that the Kyoto Protocol has failed to curb CO2 emissions as key countries such as the US and Australia decided not to ratify the protocol. However, we believe some change is afoot with US President Elect Obama's last week pledge to "...engage vigorously..." in international climate change negotiations scheduled to end in December 2009 in Copenhagen and alternative energy investment featuring highly in the new Democrat government's fiscal stimulus package.

**Table 1: Major turbine manufacturers outlook**

Company name	Recent qtr order book	Management remarks
GE	↑52% YoY to US\$2.3b	Total wind commitments (equipment and services) at US\$14.0b. See strong global demand. Energy sector guiding up 15% YoY in 4Q.
Gamesa	Remains above 11,500MW	Global supply chain operating at 100% with a diversified geographical sales mix. Expects raw material prices to stabilize.
Suzlon	2,505MW	50% planned volume from India and China, 20-25% from the US (full for 2009). Expects India and China markets to grow 40% in 2009.
REPower	↑25% YoY to EUR1.5b	Order books full for FY3/09. Order visibility to 2015. Expects strong industry growth led by Europe and the US.
Vestas	↑48% YoY to EUR6.5b	Order books across Europe, Americas and Asia Pacific. No cancellations (as of 6 November). Expects cumulative MW shipments to double the 2007 figure by 2010. Set up new sales unit in China.
Goldwind	2,444MW	Plans continuous investment into wind power by the government and IPPs. Expects mid to low single digit impact from BP JV. Seeking new project partner.

Source: Company data

**Need for wind.** The world's installed wind capacity was 94,005MW at end-2007 and is estimated to grow at a CAGR of 25% to 287,940MW by end-2012, according to BTM Consult. China currently has the fifth largest installed wind capacity (6,050MW) and is one of the fastest growing countries in terms of wind generation, with plans to reach 30,000MW by 2020 and require independent power producers (IPPs) to derive 3% of their electricity generation from non-hydro renewables by 2010 and 8% by 2020.

**CHST - key player in the wind turbine supply chain.** China High Speed Transmission (CHST), one of the country's leading manufacturers of transmission gear boxes for wind turbines, is well positioned to capitalize on the increasing migration of wind turbine manufacturing and assembly to China. Gear boxes are key components of wind turbines and along with rotary blades are traditionally the supply bottlenecks within the manufacturing supply chain. CHST is one of General Electric's (GE) key suppliers of wind gear boxes and has various research and development initiatives with the US-based partner, including gear boxes for 1.5MW and 2.5MW turbines. The 1.5MW turbine is a sales workhorse within GE's energy infrastructure segment, while the industry as a whole is preparing for the mass migration to 2MW+ turbines. The wind gear operation is the fastest growing segment within CHST's product portfolio. The company also produces gearing equipment for various industries, such as marine, railway, steel and construction.

**Table 2: Revenue breakdown**

Year to Dec (RMBm)	05A	06A	07A	1H07A	1H08A
Wind gear	26.5	317.7	717.4	308.2	573.7
Marine gear	0.7	3.2	135.6	23.2	231.4
Construction gear	307.8	195.4	362.2	165.2	222.8
General purpose gear	90.2	139.2	144.0	61.1	82.7
High speed gear	27.5	17.7	28.8	13.5	11.7
Rolling gear	301.0	289.2	293.5	166.6	121.6
Others	192.9	221.9	223.2	135.1	106.4
Total	946.7	1,184.3	1,904.8	873.0	1350.3

Source: Company data

**Independent wind gear box producer.** The wind gear box industry is dominated by Winergy and Hansen Transmissions, which collectively account for 60-70% of the market. Since Winergy was acquired by Siemens and 80% of Hansen was bought by Suzlon, an Indian turbine manufacturer, CHST became one of the largest independent wind gear box producers. We believe his independence will allow it to gain market share from other industry players.

**Wind revenue – a core earnings driver.** CHST's wind turbine customers include international and domestic leaders such as GE, REPower, Dongfang, Goldwind and Shanghai Electric. Through technology transfer (from joint development projects with GE and Goldwind), the company has gained technology

competency and price competitiveness. According to our channel checks, CHST's wind gear boxes are 20-25% cheaper than those made by its international peers. Based on our preliminary estimates, CHST can increase its wind revenues at a CAGR of 76.6% from FY12/07A to FY12/10A.

**Table 3: Gross margin breakdown**

Year to Dec (%)	05A	06A	07A	1H07A	1H08A
Wind gear	10.4	26.7	27.5	24.5	29.9
Marine gear	49.3	10.8	22.0	28.1	26.5
Construction gear	29.6	32.1	29.8	25.7	31.8
General purpose gear	33.2	35.0	36.1	28.6	35.3
High speed gear	36.8	34.6	53.7	53.7	64.0
Rolling gear	25.9	32.6	34.3	23.6	36.7
Others	32.4	19.7	22.3	32.9	30.2
Total	29.0	28.8	29.0	26.7	30.9

Source: Company data

**1H FY12/08A results.** CHST's 1H FY12/08A revenue jumped 54.7% YoY to RMB1,350.3m with increases across all segments. Its net profit (ex. extraordinary items) increased 95.4% YoY to RMB177.2m. Wind gear revenue surged 86.2% to RMB573.7m and construction gear and general purpose gear revenue 34.9% YoY and 35.3% YoY to RMB222.8m and RMB82.7m, respectively. Gross margin for the company rose 4.2pcp YoY to 30.9%. During the period, the company also recorded other expenses amounting to RMB64.7m (1H FY12/07A: nil), of which RMB29.7m was in forex losses (as CHST sells some of its products in overseas denominated currencies) and RMB34.9m was expenses related to the issue of a CB.

**Table 4: Interim results**

Six months to Jun	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit* (RMBm)	Tax rate (%)	Net profit* (RMBm)	EPS* (RMB)	DPS (RMB)
1H FY08	1,350.3	417.3	30.9	211.0	11.7	177.2	0.142	0.070
1H FY07	873.0	233.1	26.7	141.0	5.0	133.8	0.150	0.039
YoY (%)	54.7	79.0		49.6		32.4	5.3	79.5

\* excluding extraordinary items of 1) changes in FV of derivative financial instruments (equity swap) and 2) change in FV of CB

Source: Company data

**Key concern.** CHST has a RMB1,996.3m USD-settled zero coupon convertible bond (exercise price HK\$17.78) due in May 2011 at 109.3% on the principal. It also entered into a cash-settled equity swap transaction with Morgan Stanley (with an initial price of HK\$13.6783) for its shares up to a value of HK\$1,113.0m. With the company's share price currently far out of the money, the investment community is concerned if CHST can maintain its capex plans (currently at RMB1.8b, RMB1.0b and RMB800.0m for FY12/08F-10F) while meeting its CB and equity swap obligations. Excluding the RMB978.5m restricted cash (for the equity swap), the company had RMB1,707.4m in cash at end-1H FY12/08A and minimal bank borrowings. To date, CHST has redeemed RMB581.0m worth of CBs at a consideration of RMB360.4m. based on our back of pad estimates of CHST's operating cash flow from FY12/08F to FY12/10F of RMB656.2m, RMB815.7m and RMB1202.3m, the company would be in a cash position of RMB527.6m at the start of FY12/11F. With operating cash flow from FY12/11F, bank financing of between RMB600.0-900.0m (and conservatively assuming no contribution from the equity swap), the company should be able to meet its CB equity swap obligations in FY12/11F.

**Valuation.** The counter is currently trading at 12.4x FY12/08F and 8.7x FY12/09F based on consensus estimates.

Table 3: P&amp;L

Year to Dec (RMBm)	05A	06A	07A	1H07A	1H08
Turnover	946.7	1,184.3	1,904.8	873.0	1,350.3
Cost of sales	(672.1)	(843.5)	(1,351.8)	(639.8)	(932.9)
Gross profit	274.6	340.8	553.1	233.1	417.3
Other net (loss)/income	14.3	23.3	192.3	67.1	47.5
Selling and distribution costs	(44.2)	(55.7)	(79.3)	(34.4)	(40.0)
Administrative expenses	(102.6)	(137.5)	(282.2)	(95.8)	(129.1)
R&D expenses	(8.3)	(14.7)	(22.9)	(7.9)	(10.4)
Other expenses	-	-	-	-	(64.7)
Operating profit	133.9	156.2	361.0	162.1	220.6
Financial costs	(21.2)	(41.5)	(33.0)	(19.9)	(8.6)
Share of an associate	-	(0.8)	(3.6)	(1.2)	(0.9)
FV chg on derivative financial	-	-	-	-	121.6
FV chg on CBs	-	(20.1)	-	-	(46.0)
Profit before tax	112.7	93.7	324.3	141.0	286.6
Tax	(13.3)	(3.5)	(17.9)	(7.1)	(33.6)
Minority interests	(17.6)	(4.6)	0.2	(0.2)	(0.2)
Net profit	81.8	85.6	306.7	133.8	252.8

Source: Company data, SBI E2-Capital

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