

Company Flash

CW Group Holdings Limited

1322 HK

Setting its way to tap China market

- Precision engineering solution and CNC machining centres continues to lead the growth of the company
- We believe the two segments will maintain high growth given International industrial companies tend to set up production lines in Southeast Asia and high potential in the China market
- After sales technical supports service is expected to account for a bigger proportion of the total revenue when the precision engineering solution segment becomes more mature in the future

CW Group is principally engaged in the provision of precision engineering solution and the manufacturing and distribution of machine tool and cement production equipment.

What's New. CW group announced an interim result for 1H FY12/13. Revenue was up by 15.6% YoY to HK\$434.1m, driven by the increase of sales from precision engineering solution projects and the sales of CNC machining centres, which respectively grew by 33% YoY and 5236% YoY (See fig 2). However, gross profit was down by 8% YoY on a lower gross margin, which was down by 5.3ppts YoY to 21% in 1H FY12/13. Due to the absence of listing expenses during 1H FY12/13, net profit attributable to shareholders for 1H FY12/13 was up by 26359% from HK\$0.2m to HK\$55.8m. Excluding the listing expenses, net profit attributable to shareholders was up by 13% YoY to HK\$55.8m. The company did not propose any interim dividend for 1H FY12/13 (1H FY12/12: Nil).

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Stock Data

	Not Rated
Rating	Not Rated
Price (HK\$)	2
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.25-2.5
Market cap. (US\$m)	1,232.8
3M average Daily t/o (US\$m)	5,984,421.0
Free float (%)	25.8

Source: Bloomberg

Financial Summary

Year to Dec	10A	11A	12A
Turnover (HK\$ '000)	469,450	753,566	818,535
Gross profit (HK\$ '000)	145,244	179,469	223,082
Net profit (HK\$ '000)	50,620	68,015	55,115
EPS (HK cents)	4.00	14.58	9.57
DPS (HK cents)	0.00	0.00	0.00
P/E (x)	48.75	13.374	20.376
P/B (x)	n.a.	5.6	2.1

Source: Bloomberg

Figure 1: Snapshot of the interim result for 1H FY12/13 & 1H FY12/12

	1H FY12/13	1H FY12/12	YoY Change
	HK\$'000	HK\$'000	
Total Revenue	434,078	375,403	16%
Gross profit	90,313	98,037	-8%
Operating profit	69,786	67,355	4%
Net profit attributable to shareholders	55,829	211	26359%
Net profit attributable to shareholders (adjusted for listing expenses and fair value changes)	55,829	49,611	13%

Source: the company

Figure 2: Revenue breakdown for 1H FY12/13 & 1H FY12/12

	1H FY12/13	1H FY12/12	YoY Change
	HK\$'000	HK\$'000	
Precision engineering solution projects	284,268	213,117	33%
Sales of CNC machining centres	32,071	601	5236%
Sales of cement production equipment	44,642	51,171	-13%
Sales of components and parts	15,926	87,794	-82%
After-sales technical support services	57,171	22,720	152%
Total Sales	434,078	375,403	16%

Source: the company

Figure 3: Gross margin breakdown for 1H FY12/13 & 1H FY12/1

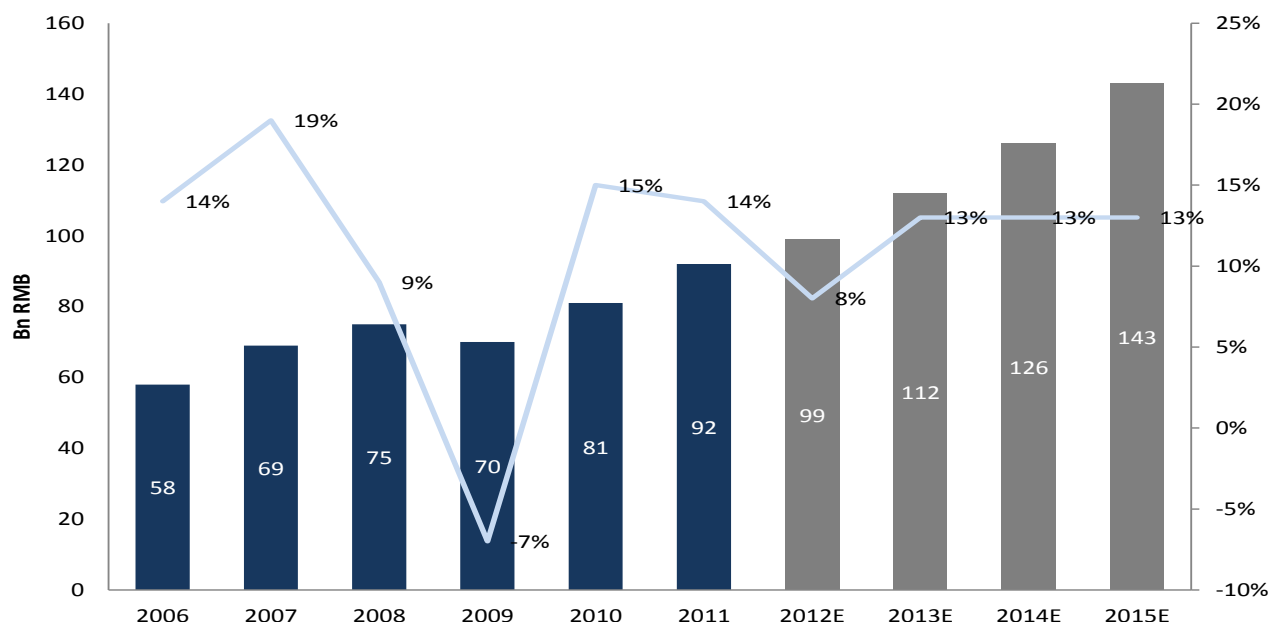
	1H FY12/13	1H FY12/12	YoY Change
	HK\$'000	HK\$'000	(ppts)
Precision engineering solution projects	21%	26%	-5.2
Sales of CNC machining centres	25%	30%	-4.4
Sales of cement production equipment	28%	39%	-11.2
Sales of components and parts	-16%	8%	-24.0
After-sales technical support services	22%	65%	-42.9
Blended gross margin	21%	26%	-5.3

Source: the company

Precision engineering solution and CNC machining centres lead the growth. Revenue generated from the precision engineering solution and CNC machining centres grew by 33% and 5236% respectively in 1H FY12/13. We note that the abnormal high growth in the CNC machining segment is partly due to a low base in the previous year. These two segments cumulatively contributed 72.9% and 56.9% of the total revenue in 1H FY12/13 and 1H FY12/12.

We believe this segment will maintain high double-digit growth and will become the growth driver of the company going forward because: 1) International industrial companies are inclined to set up production lines in Southeast Asia for cost-saving reason, and CW group is one of the few companies that provide turn-key precision engineering solutions to customers in those area and 2) there is high potential in the China market. China only contributed 12.9% of the company's total revenue in 1H FY12/13. But given upward pressure on wages in the industrial market and higher efficiency achieved by automation systems, industrial automation market in China is set to grow. In fact, the size of industrial automation market in China has increased at a CAGR of 9.7% during the 5-year period between 2006 and 2011, and it is expected that it will grow at a CAGR of 11.7% during the 4-year period between 2011 and 2015 (See fig. 4).

Figure 4: China Industrial automation market size



Source: New Pacific Consulting

After-sales technical support service. While revenue generated from after-sales technical support service just accounted for 13.2% of the total revenue in 1H FY12/13, we believe the revenue generated from after-sales technical support services will account for a bigger proportion of the total revenue (1H FY12/13: 13.2%) when the precision engineering solution segment becomes more mature. The management reveals that normally a 1-year warranty will be provided to the customers, and after that the company will charge its clients a fee for maintenance services with annual fee equalling 5% to 10% of the original contract value. This segment is recurring in nature and will provide a stable cash flow to the company.

Sales of cement products was adversely affected by the cooling measures on property sector. Revenue generated from sales of cement production equipment was down by 13.0% YoY to HK\$44.6m, contributing 10.3% of the total revenue in 1H FY12/13. We do not expect this segment to experience a notable growth in the near future, as the construction sector in China continues to slow down, and this segment will most likely be treated as an auxiliary business of the company going forward.

Valuation. Currently CW group is trading at a 1-year trailing P/E of 20x. However, as mentioned earlier, profit in FY12/12 was negatively affected by the listing expenses, which is one-off in nature. Excluding the listing expenses, 1-year trailing P/E of the company is actually 13.9x, which is around the average level of its peers who are on average trading at a 1-year trailing P/E of 14.6 (See fig. 5). This implies a fair valuation of the company at the current price level.

Figure 5: Profit and loss items

Company	Ticker	Mkt Cap (RMB m)	3M avg turnover (RMB m)	2012E P/E (x)	2013E P/E (x)	P/book (x)	Net profit (RMB m)	ROIC (%)	ROE (%)	ROA (%)	Dvd Yield (%)	Net Debt/Total Equity
CW Group	1322 HK	948.77	4.82	20.38	9.75	2.11	55.12	14.96	13.99	5.45	0.00	5.08
United Pacific Industries	176 HK	508.92	0.22	9.92	9.14	1.45	60.57	8.65	14.31	6.44	2.34	-19.54
Zoomlion Heavy Industry	1157 HK	44,822.65	65.26	9.01	7.37	0.99	7,330.00	8.23	11.37	5.23	3.70	14.56
Lonking	3339 HK	6,047.27	33.28	27.66	12.73	0.91	151.49	4.31	3.36	1.49	0.00	70.28
Sany Heavy Equipment	631 HK	5,927.91	9.42	18.57	10.37	1.04	499.53	5.26	5.45	3.79	2.62	-13.34
Chongqing Machinery	2722 HK	2,849.95	3.87	7.96	6.19	0.54	440.77	2.65	7.03	2.84	4.53	0.57
Shenji Group Kunming Machine Tool	300 HK	2,201.21	0.36	n.a.	n.a.	0.65	-73.22	n.a.	-9.02	-4.54	n.a.	2.58
	avg*	10,392.99	18.74	14.63	9.16	0.93	1,401.52	5.82	5.42	2.54	2.64	9.19

Source: The Company

* CW group is not included in the average figures

Risks. Investing in CW Group is not without risks. Major investment risks include 1) Increase in market competition that may lead to decrease in market share, 2) increase in material costs and labor costs, 3) lose of agency rights to the products the company supplies, 4) slower-than-expected development of industrial automation in China and 5) failure to collaborate with KIWA and DMPG, which may adversely affect the sales of the CNC machining centres.

Figure 6: Profit and loss items

HK\$'000	FY12/10	FY12/11	FY12/12	1H FY12/13
Revenue	469,450	753,566	818,535	434,078
Cost of sales	-324,206	-574,097	-595,453	-343,765
Gross profit	145,244	179,469	223,082	90,313
SG&A	-46,215	-62,100	-99,275	-31160
Other operating expenses	-1,060	-745	-15,720	0
Profit from operation	97,969	116,624	108,087	59,153
Finance costs	-28,669	-25,466	-30,830	-4,409
Other income and gains	2,064	1,369	3,498	10,633
Income tax expenses	-20,744	-24,512	-25,640	-9,548
Profit for the year	50,620	68,015	55,115	55,829
Profit attributable to shareholders	26,852	68,015	55,115	55,829
Minority Interest	23,768	0	0	0
Basic EPS (HK cents)	4.00	14.58	9.57	9.06

Source: The Company

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