

Results Update

Jiangnan Group

1366 HK

Benefitting from increased UHV power grid development in China

- Jiangnan Group recorded net profit attributable to shareholders of RMB503.5m in FY12/13, a YoY increase of 33.9%.
- China's investment into UHV power grids will increase by 13-fold in the 12th Five-year Period. The company looks to benefit as it is one of the few players in the industry who can produce UHV power cables.
- The company completed its 1st M&A since listing on the HKEx in 2012. The management revealed that they are planning to acquire another wire company in FY12/14.

Nelson Lee, CFA, FRM

(852) 2533 3708

sbie2research@sbie2capital.com

Stock Data (1366 HK)

	Not Rated
Rating	Not Rated
Price (HK\$)	1.79
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1-1.8
Market cap. (HK\$m)	5,508.2
Daily t/o (HK\$)	12.2
Free float (%)	24.6

Source: Bloomberg

What's new: Jiangnan Group, a company engaged in the manufacture and trade of wires and cables for power transmission, distribution systems, and electrical equipment, released their annual results for FY12/13. We attended its annual results presentation in early April to obtain updated information on the company.

In FY12/13, the company's revenue was up 20.9% YoY to RMB6,477.3m, mainly driven by an increase in power cable sales (FY12/13: RMB4,239.7m vs. FY12/12: RMB3,701.3m) and revenue contributions from its rubber cable business (FY12/13: 375.9m vs. FY12/12: Nil), which the company acquired in July 2013 at a consideration of RMB500.0m. The company's overall gross margin remained constant at ~15.0%.

For the year the company recorded net profit attributable to shareholders of RMB503.5m, a 33.9% YoY increase. The company actually performed significantly better in 2H FY12/13 than in 1H FY12/13 (profit in 1H: RMB149.4m vs. 2H: RMB354.1m). The difference in performance between 1H and 2H FY12/13 was due to two reasons: 1) Their newly acquired business started contributing revenue in the 2H; and 2) Its factory utilization rate in the 1H is normally lower than in the 2H due to the Chinese New Year holiday.

The board declared a final dividend of HK3.3 cents per share for FY12/13. Together with the declared interim dividend, total dividend per share for the year amounted to HK4.7 cents per share, representing a payout ratio of 28.7% (FY12/12: 31.3%).

Figure 1: Financials and valuation

	FY12/11	FY12/12	FY12/13
Total revenue (RMB m)	4,929.9	5,356.4	6,477.3
Revenue growth (YoY)	33.7%	8.7%	20.9%
EBIT (RMB m)	515.0	638.0	804.1
EBIT growth (YoY)	46.3%	23.9%	26.0%
Net profit (RMB m)	317.4	376.1	503.5
Net profit growth (YoY)	36.9%	18.5%	33.9%
EPS (RMB cents)	26.5	13.1	16.4
DPS (HKD cents)	-	4.1	4.7
P/E (x)	5.4	10.9	8.7
Dividend yield	-	2.3%	2.6%

Source: The company

Figure 2: Revenue and gross margin breakdown

	Revenue (RMB '000)			Gross margin (%)		
	FY12/13	FY12/12	Change (%)	FY12/13	FY12/12	Change (ppt)
Power cables	4,239,666	3,701,286	14.5%	16.8%	17.1%	-0.3
Wire and cables for electrical equipment	1,513,652	1,326,750	14.1%	10.1%	13.6%	-3.5
Bare wires	348,122	328,327	6.0%	12.6%	9.1%	3.5
Rubber cables	375,862	-	-	24.8%	-	-
Total	6,477,302	5,356,363	15.0%	15.4%	15.7%	-0.3

Source: The company

Figure 3: Major customers of Jiangnan

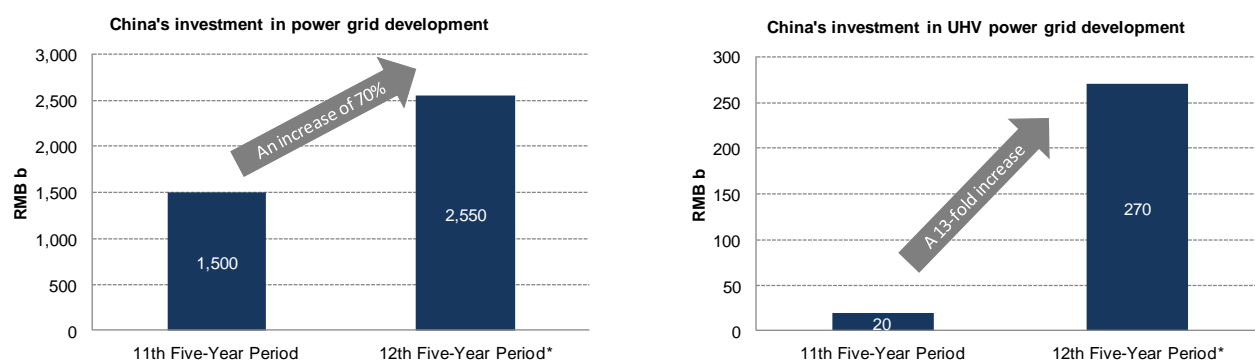
Electricity		Metal and Oil	Transportation	Shipping
China	Foreign			
State Grid Corporation of China	Eskom (South Africa)	CNPC	Shenzhen Metro	CSSC-MES Diessel Co.
China Datong Corporation	Powerworks (Singapore)	Sinopec	Shanghai Metro	Qingdao Port Group
China Southern Power Grid	National grid (Britain)	China Shenhua	China CREC Railway Electrification Bureau Group	
China Huadian Corporation		Huinan Mining Group		

Source: The company

Benefitting from favorable Chinese government policies: Over the past 4 years the profit of the company has been growing steadily, with a 4-year CAGR of 32.6% (26.6% excluding its M&A factor). The growth is mainly driven by 3 factors: 1) the continuation of rural reform in China, which, due to increased infrastructure projects and power grid enhancement in rural areas, continues to increase demand for wires and cables. 2) continued increases in China's urbanization rate boosting demand for wires and cables, as both are used in construction work in the property and railway sectors; and 3) the increasing popularity of green energy leading to greater ultra-high voltage (UHV) cable consumption as these cables are used to reduce energy loss during transmission across long distances.

According to the 12th Five-Year Plan, China plans to invest RMB2,550.0b into the country's power grid during the 5-year period, up ~70.0% from the RMB1,500.0b it invested during the 11th Five-Year Plan period. In addition, within the RMB2,550.0b, RMB270.0b will be allocated to developing the country's UHV power grid (11th Five-Year Plan period: RMB20.0b). As the government seeks to complete its "3 horizontal, 3 vertical," and "5 horizontal, 5 vertical," UHV synchronous grids by 2015 and 2020, respectively, we believe the government will continue to increase its investment in UHV power grid development in the foreseeable future.

Figure 4: China's investment in power grid and UHV power grid development



Source: The company

* China government's target

UHV cables accounted for only ~5.0% of the company's total sales in FY12/13. However, we believe, with more investment from the government and capacity expansion in the coming years, the proportion will gradually increase. Increased sales of UHV cables would also boost the overall profitability of the company as the product commands higher gross margin than other power cable products (FY12/13: ~25.0% vs. ~17.0%).

M&A opportunities boost inorganic growth: We also expect some inorganic growth in the company going forward. In fact, the company recently completed its first M&A deal since listing on the HKEx in 2012. In April 2013, it acquired a 100.0% equity interest in Jiangsu Zengyang Investment Company Limited, which holds 100.0% of the equity in Zhongmei Cable, a company engaged in the manufacture and sale of rubber cables, which are mainly used in wind power systems, shipbuilding, and mining industries in China. The rubber cables also command a higher gross margin than other products the company offers (See Figure 2). Jiangnan's management mentioned that they will continue to seek other M&A opportunities, and that they are currently planning to acquire another high-end wire and cable company in China this year.

In fact, the wire and cable industry in China is highly fragmented with more than 4,000 players, the largest 19 of which (in terms of revenue) cumulatively command only ~12.0% market share (Jiangnan ranks 3rd and commands market share of ~2.0%). In addition, according to data provided by the China Electrical Equipment Industry Association and the Ministry of Industry and Information Technology of the PRC, more than 90.0% of the players in the industry do not have the capacity to produce high voltage and UHV cables (due to the lack of technology and high up-front investment costs), and have the capacity to produce only low to mid voltage power cables. As well, with tightening liquidity and intensified competition, small players in the industry may find it harder to survive, and may eventually exit the market. We therefore expect more consolidation in the industry going forward.

Commodity prices and finance costs remain our concern: Generally, we are quite positive about the company and believe it will continue to grow steadily. However, some concerns remain, e.g., the fall in copper prices may hurt profit. Although raw material costs and selling prices of its products may come down simultaneously with lower copper prices, gross margin might be lower due to the time gap between procurement of raw material and selling of its products. As well, liquidity contraction in the market may raise its borrowing costs, which will significantly affect the company because of its need to refinance its bank obligations due to the mismatch of cash flow borne from the nature of its business and its required expenses. (The company needs to pay up front for copper, a major factor input for its products, but its clients pay in full only after the products or services are delivered.)

Valuation: Valuation wise, at a market price of HKD1.79 per share, the company is trading at a prospective P/E of 7.55x. Its peers, however, are trading at much higher valuations. While its HK-listed peers are on average trading at 11.4x, its China-listed peers are trading at 16.4x (See Figure 5). The discount at which the company is trading to its Hong Kong peers may be due to lower technology requirements for producing wire than for producing the electrical distribution systems and electronic power meters that Boer Power (1685 HK, HKD10.7) and Wasion Group (3393 HK, HKD5.5) offer, which results in a lower profitability of the company's products. It also has a lower market capitalization and turnover volume than its China peers. However, we believe that the company will deserve a better valuation if it can improve its profitability by increasing the sale of its UHV cable products and acquire more high-end wire companies in the future.

Figure 5: Peer comparison

Company	Ticker	Mkt Cap (HKD m)	3M avg turnover (HKD m)	2013 P/E (x)	2014E P/E (x)	2013 P/B (x)	Trailing 12M net margin (%)	Trailing 12M net margin (%)	Dvd Yield (%)	Net Debt/Total Equity (%)
HK-listed										
Jiangnan Group	1366 HK	4,861.98	12.20	8.74	7.55	1.90	7.77	15.87	2.27	85.64
Boer Power	1685 HK	8,603.28	13.04	18.72	13.91	3.38	25.49	35.99	1.27	(59.11)
Wasion Group	3393 HK	5,208.31	12.30	10.25	8.81	1.56	16.63	33.94	3.22	0.75
HK-listed average*		6,905.79	12.67	14.48	11.36	2.47	21.06	34.97	2.24	(29.18)
China-listed										
Baosheng Science and Technology	600973 CH	4216.33	81.22	30.36	-	1.72	1.16	7.99	-	77.91
Jiangsu Zhongtian Technology	600522 CH	10773.58	461.14	16.40	13.05	1.65	7.80	21.05	-	16.76
Zhejiang Wanma Cable	002276 CH	7101.37	97.68	25.59	20.20	2.38	4.55	14.93	-	16.03
Jiangsu Tongding Optic-electronic	002491 CH	5499.38	63.88	19.76	16.08	2.37	7.76	23.47	1.25	61.37
China-listed Average		6,897.67	175.98	23.03	16.44	2.03	5.32	16.86	1.25	43.02
Average of all*		6,900.38	121.54	20.18	14.41	2.18	10.56	22.89	1.91	18.95

Source: Bloomberg, SBI E2-Capital

* Average figure does not include Jiangnan Group

Risks: Major risks include: 1) delays in government investment in the power grid industry; 2) over-capacity caused by intense competition; 3) decreases in commodity prices which may lead to gross margin erosion; 4) reductions in factory utilization rates; and 5) increases in interest rates raising borrowing costs.

Figure 6: Per share items

	FY12/11	FY12/12	FY12/13
EPS (RMB cents)			
- Basic & diluted	26.5	13.1	16.4
DPS (HKD cents)	-	4.1	4.7
BVPS (RMB cents)	38.4	61.1	74.3

Source: The company

Figure 7: Ratio analysis

	FY12/11	FY12/12	FY12/13
Growth (YoY)			
Revenue	33.7%	8.7%	20.9%
Gross profit	38.4%	14.6%	18.8%
Operating profit	46.3%	23.9%	26.0%
Net profit	36.9%	18.5%	33.9%
Margins			
Gross margin	14.9%	15.7%	15.4%
EBIT margin	10.4%	11.9%	12.4%
Net profit margin	6.4%	7.0%	7.8%
Other ratios			
Return on average assets	8.8%	7.9%	7.8%
Return on average equity	30.9%	24.6%	24.2%
Dividend payout ratio	-	31.3%	28.7%
Valuation measures			
P/E (x)	5.4	10.9	8.7
P/B (x)	3.7	2.3	1.9
Dividend yield	-	2.3%	2.6%

Source: The company

Figure 8: Income statement (RMB m)

	FY12/11	FY12/12	FY12/13
Revenue	4,929.9	5,356.4	6,477.3
Cost of sales	(4,195.0)	(4,514.0)	(5,476.9)
Gross profit	734.9	842.4	1,000.4
Other income or loss	(20.6)	(24.3)	3.9
SG&A	(199.4)	(180.1)	(242.5)
Other	-	-	42.3
Operating profit	515.0	638.0	804.1
Finance costs	(126.4)	(182.2)	(195.3)
Share of profit of an associate	-	-	(3.5)
Profit before taxation	388.6	455.8	605.3
Income tax	(71.2)	(79.7)	(101.8)
Profit attributable to shareholders	317.4	376.1	503.5

Source: The company

Figure 9: Balance sheet (RMB m)

	FY12/11	FY12/12	FY12/13
Non-current assets			
PP&E	346.7	472.6	632.9
Land use rights	50.0	79.2	207.7
Interest in associates	-	-	15.2
Loan to an associate	-	-	30.4
Available-for-sale investment	-	-	2.5
Deferred tax asset	-	5.2	6.6
Deposit paid for acquisition of PP&E	15.3	2.6	1.3
Total non-current Assets	412.0	559.6	896.5
Current assets			
Inventory	1,185.9	1,003.3	1,842.2
Trade and other receivables	1,427.4	1,830.9	2,328.4
Pledged bank deposits	482.2	755.1	807.6
Cash and cash equivalent	677.9	1,137.7	1,682.6
Total current assets	3,773.4	4,727.1	6,660.8
Total assets	4,185.4	5,286.6	7,557.3
Current liabilities			
Trade and other payables	(1,539.5)	(1,404.8)	(2,223.2)
Amount due to directors	(13.3)	(1.4)	(3.7)
Bank borrowings	(1,401.8)	(1,934.5)	(2,922.1)
Taxation payable	(23.2)	(32.5)	(54.4)
Total current liabilities	(2,977.8)	(3,373.3)	(5,203.4)
Non-current liabilities			
Government liabilities	(5.3)	(4.9)	(4.4)
Deferred tax liabilities	(20.2)	(27.7)	(63.8)
Total non current liabilities	(25.5)	(32.6)	(68.3)
Net assets	1,182.0	1,880.8	2,285.7
Equity			
Share capital	85.7	25.0	25.0
Reserves	1,096.3	1,855.8	2,260.7
Total equity	1,182.0	1,880.8	2,285.7

Source: The company

Figure 10: Cash flow statement (RMB '000)

	FY12/11	FY12/12	FY12/13
Operating activities			
Profit before taxation	388.6	455.8	605.3
Adjustment for			
Interest income	(13.1)	(29.1)	(20.9)
Finance costs	126.4	182.2	195.3
Depreciation	30.8	35.4	47.5
Loss on disposal	0.0	1.3	0.1
Other	12.71	23.41	-
Operating cash flows before movements in working capital	545	669	827
Change in working capital	(160.3)	(402.8)	(571.7)
Tax paid	(56.7)	(68.1)	(45.6)
Net cash generated from operating activities	328.3	198.1	210.0
Investing activities			
Interest received	6.8	29.1	20.9
Proceeds from disposal of PP&E	0.3	10.2	-
Purchase of PP&E	(35.1)	(123.0)	(206.6)
Purchase of land use rights	-	(31.2)	(128.5)
Release of pledged bank deposits	768.5	1471.4	-
Bank deposits pledged	(1073.4)	(1744.3)	(52.5)
Other	7.8	0.1	(48.1)
Net cash flow from investing activities	(325)	(388)	(415)
Financing activities			
Interest paid	(127.2)	(193.9)	(195.3)
Expenses incurred in connection with the issue of shares	-	(20.7)	-
Dividends paid	-	(47.2)	(34.1)
Net new borrowing	408	533	989.9
Proceeds on issue of shares	-	390.7	-
Other	(226.31)	(11.87)	-
Net cash flow from financing activities	54.7	649.6	760.5
Net increase in cash and cash equivalent	58.0	459.9	555.7
Cash and cash equivalents at the beginning of the year	622.4	677.9	1137.7
Effect of foreign rate exchange	(2.49)	(0.07)	(10.89)
Cash and cash equivalents at the end of the year	677.9	1,137.7	1,682.6

Source: The company

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