

## Results Update

# CSR Corporation Ltd. 1766 HK

## An opportunity along a risk in front

- CSR will potentially benefit from railway construction support including a RMB630.0 billion investment into the railway industry and the planned Railway Development Fund (RDF)
- Uncertainty from the side of China Railway Corporation still exists

**What's new:** CSR is one of the largest rolling stock manufacturers and solution providers in the world, offering a wide range of rolling stock products and services. The company is also the second largest rolling stock manufacturer in China based on revenue in FY12/13. Compared with the revenue generated from CNR, the largest participant in the industry, revenue from CSR only lacked RMB715.6m behind, around 0.7% of CSR's revenue in FY12/13. The company kept steady growth in FY12/13, recording revenue of RMB96,525.0m, a 8.4% YoY increase; gross profit of RMB16,629.0m, a 5.5% YoY increase with gross margin of 17.2%; and net profit attributable to shareholders of RMB4,140.0m, a 3.3% YoY increase.

CSR's revenue composition in FY12/13 largely consisted of 20.6% from locomotives, 19.9% from multiple units, and 13.5% from new business, which included wind power equipment, electric automobiles, and composite materials (See Figure 1). These three larger business segments make up CSR's core businesses, account for 54.0% of the company's total revenue.

**David Lee**

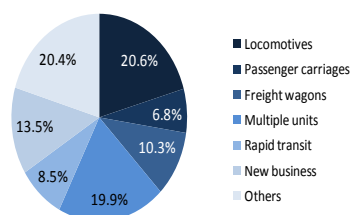
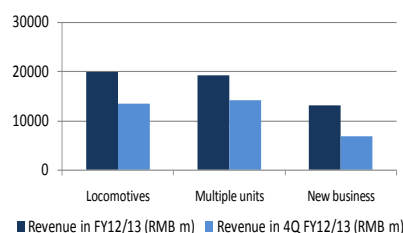
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**Stock Data (1766 HK)**

Rating	Not Rated
Price (HKD)	5.84
Target Price (HKD)	n.a.
12m Price Range (HKD)	4.16-7.35
Market cap. (HKD m)	75,202.6
Daily t/o (HKD m)	102.9
Free float (%)	95.0

Source: Bloomberg

**Figure 1: CSR revenue breakdown**

**Figure 2: FY12/13 vs. 4Q FY12/13**


Source: Company data

**CSR will benefit from railway construction support:** On 2 April, Premier Li Keqiang held a State Council meeting in which he called upon 3 minor methods to stimulate China's currently sluggish economy. These 3 methods included: (i) extending the current preferred tax policy and lowering the corporate tax on small enterprises; (ii) speeding up reconstruction of slums as part of the government's larger urbanization plan; and (iii) moving forward with the construction of railway investment projects. Premier Li believes that increased investment in railway construction is a good method for shoring up the economy, especially in rural areas. Accordingly, under the third stimulus plan China's central government will allocate 80.0% of the new RMB630.0m Fixed Asset Investment (FAI) to the central and eastern areas in China.

In this regard, we believe further subsidies will be provided from the central government to China Railway Corporation (CRC) via the following methods: (i) direct financial support, e.g., subsidies; and (ii) helping CRC to find more sources of funding, e.g., bonds. After receiving said financial support, CRC will easily have enough capital to carry out its investment plan for 2014.

Additionally, figure 3 describes the actual amount of money invested by CRC before 2014, and also its expected amount of investment in 2014. In Jan this year, CRC held an annual conference in which the company detailed its investment plan into the railway industry in China. According to its plan, CRC expects to invest around RMB630.0 billion, RMB130.0 billion of which is to be allocated to equipment purchases. As well, under this plan, 460 multiple units, 1,200 locomotives, and 2,200 passenger carriages will be purchased. We can see that investment in new rolling stocks has increased around 13.0%. From this point of view, we think CSR has an opportunity to capitalize on its forthcoming asset purchases.

**Figure 3: Investment into China's railway industry by CRC**

	Total FAI (RMB b)	Investment in basic construction (RMB b)	Investment in new rolling stock (RMB b)
2010	823.5	700.0	100.0
2011	589.0	460.0	73.0
2012	630.0	518.0	80.0
2013	660.0	520.0	115.0
2014 E	630.0	490.0	130.0

Source: Zhongguo Wang

**Will history repeat itself in FY12/14?** For CSR, 2013 was filled with uncertainty. The company significantly cut back its production in 1H due to lack of orders from its largest client, China Railway Corporation (CRC). It was not until 4Q FY12/13 that demands from CRC picked up significantly, as evident in figure 2. Historically, orders from CRC have routinely accounted for around 60.0% of CSR's total revenue. Accordingly, any deterred demand from China Railway Corporation will heavily affect CSR's performance. Moreover, the company's specific investment schedule is still unknown; so it is still possible that these investments will be delayed to FY12/15, which means its stock price in FY12/14 is filled with uncertainty.

**Valuation:** Based on the nature of CSR's business, we chose CSR Times Elec (3898 HK, HKD23.60) and Sun King Power Electronic Group (0580 HK, HKD0.71) as its peers in Hong Kong stock market. Meanwhile, we chose its largest competitor, CNR (601299 CH, RMB4.52), along with Jinxi Axle Co Ltd (600495 CH, RMB12.10), Zhuzhou Times New Material Technology (600458 CH, RMB8.67), and Baotou Beifang Chuangye Co Ltd (600967 CH, RMB18.30) as its peer companies in A-share market. All these companies are involved in rolling stock business. The expected P/E ratio (2014) of CSR is 13.3x, which is lower than the average P/E ratio (2014) of 16.1x of the aforementioned peers in Hong Kong and also lower than the average P/E ratio (2014) of 18.0x of the peers in China.

**Figure 4: Peer comparison**

Company	Ticker	Mkt Cap (HKD m)	2013 P/E (x)	2014E P/E (x)	2013 P/B (x)	2014E P/B (x)	Net profit (HKD m)	ROE (%)	ROA (%)	Total Debt/ Total Asset
<b>HK-listed peers</b>										
CSR	1766 HK	81,250.0	16.7	13.3	1.9	1.7	5223.4	11.9	3.7	0.6
CSR Times Elec	3898 HK	29,504.5	16.4	14.0	3.5	2.3	1850.9	18.4	11.5	0.3
Sun King Power Electronics Group	0580 HK	954.1	21.2	18.2	0.9	1.0	54.1	4.2	2.5	0.4
<b>Average*</b>		<b>15,229.3</b>	<b>18.8</b>	<b>16.1</b>	<b>2.2</b>	<b>1.7</b>	<b>952.5</b>	<b>11.3</b>	<b>7.0</b>	<b>0.4</b>
<b>China-listed peers</b>										
CNR	601299 CH	61,601.8	12.3	10.5	1.3	1.2	5209.0	11.4	3.6	0.7
Jinxi Axle Co Ltd	600495 CH	6,922.8	31.5	23.6	1.9	1.9	200.6	4.7	3.3	0.3
Zhuzhou Times New Material Technology	600458 CH	7,884.8	47.6	20.2	2.1	2.1	153.4	5.0	2.5	0.4
Baotou Beifang Chuangye Co Ltd	600967 CH	10,174.1	30.3	17.9	3.6	3.2	326.2	12.4	7.4	0.3
<b>Average</b>		<b>21,645.9</b>	<b>30.4</b>	<b>18.0</b>	<b>2.2</b>	<b>2.1</b>	<b>1,472.3</b>	<b>8.4</b>	<b>4.2</b>	<b>0.4</b>
<b>Average of all*</b>		<b>19,507.0</b>	<b>26.5</b>	<b>17.4</b>	<b>2.2</b>	<b>1.9</b>	<b>1,299.0</b>	<b>9.4</b>	<b>5.1</b>	<b>0.4</b>

Source: Bloomberg

\*CSR is not included

**Risks:** Major risks include: 1) delays or order cancellations from CRC; 2) any traffic accident caused by the rolling stocks CSR produced; 3) increased competition from its peers; 4) sluggish demand from the market ex-CRC; 5) the company's inability to expand into markets outside of China as planned; and 6) substantial fluctuations in raw materials and energy costs.

Figure 5: Per share items (RMB)

	FY12/11	FY12/12	FY12/13
EPS			
- Basic	0.21	0.33	0.30
DPS	0.04	0.18	0.09
BVPS	1.63	1.91	2.37

Source: Company data

Figure 6: Ratio analysis

	FY12/11	FY12/12	FY12/13
<b>Growth (YoY)</b>			
Revenue	24.0%	12.0%	8.4%
Gross profit	35.3%	6.0%	5.5%
Operating profit	71.3%	0.8%	5.2%
Net profit	46.2%	2.3%	4.6%
<b>Margins</b>			
Gross margin	18.7%	17.7%	17.2%
EBIT margin	7.3%	6.5%	6.3%
Net profit margin	6.0%	5.5%	5.3%
<b>Other ratios</b>			
Return on average assets	4.2%	4.0%	3.7%
Return on average equity	16.9%	14.4%	11.8%
Dividend payout ratio	19.0%	54.5%	30.0%
<b>Valuation measures</b>			
P/E (x)	13.28	16.59	16.70
P/B (x)	2.27	2.09	1.89
Dividend yield	0.6%	2.7%	1.4%

Source: Company data, Bloomberg

Figure 7: Income statement (RMB m)

	FY12/11	FY12/12	FY12/13
<b>Revenue</b>	<b>79,517.0</b>	<b>89,019.4</b>	<b>96,525.1</b>
Cost of sales	(64,646.6)	(73,264.0)	(79,896.1)
Gross profit	14,870.3	15,755.4	16,629.0
Other income	818.6	1,069.7	1,481.9
SG&A	(9,751.8)	(10,840.3)	(11,647.0)
Other expenses	(169.4)	(168.8)	(347.8)
<b>Operating profit</b>	<b>5,767.8</b>	<b>5,816.1</b>	<b>6,116.0</b>
Finance cost	(993.7)	(764.4)	(546.4)
Share of profit and losses of: Joint venturers	651.0	541.0	360.3
Share of profit and losses of: Associates	17.0	(0.1)	3.5
<b>Profit before taxation</b>	<b>5,442.1</b>	<b>5,592.7</b>	<b>5,933.5</b>
Income tax	(698.9)	(740.5)	(859.3)
<b>Profit for the year</b>	<b>4,743.2</b>	<b>4,852.2</b>	<b>5,074.2</b>
Profit attributable to owners of the parent	3,864.2	4,009.5	4,140.0
Profit attributable to non-controlling interest	879.1	842.8	934.2

Source: Company data

Figure 8: Balance sheet (RMB m)

	FY12/11	FY12/12	FY12/13
<b>Non-current assets</b>			
PP&E	21,374.3	22,970.6	25,200.6
Prepaid land lease payments	4,404.1	4,456.7	4,520.6
Other intangible assets	451.0	554.3	741.9
Investments in jointly-controlled entities	1,509.7	1,753.5	2,111.2
Investments in associates	559.0	819.1	842.4
Available-for-sale investments	271.3	526.6	708.8
Deferred tax assets	362.6	469.7	586.2
Others	247.1	1,405.5	3,464.9
<b>Total non-current assets</b>	<b>29,179.0</b>	<b>32,955.9</b>	<b>38,176.6</b>
<b>Current assets</b>			
Inventories	17,842.0	18,770.2	17,721.1
Trade and other receivables	21,952.5	38,412.6	48,774.5
Cash and cash equivalents	23,092.5	14,497.3	14,905.1
Others	720.3	581.3	1,552.1
<b>Total current assets</b>	<b>63,607.3</b>	<b>72,261.4</b>	<b>82,952.8</b>
<b>Total assets</b>	<b>92,786.4</b>	<b>105,217.3</b>	<b>121,129.4</b>
<b>Current liabilities</b>			
Trade and other payables	(39,835.3)	(51,592.5)	(57,896.6)
Interest-bearing bank and other borrowings	(18,099.1)	(8,595.6)	(7,606.3)
Tax payable	(490.4)	(461.2)	(500.7)
Provision for warranties	(400.9)	(479.5)	(595.2)
Others	(359.2)	(409.6)	(401.4)
<b>Total current liabilities</b>	<b>(59,184.9)</b>	<b>(61,538.4)</b>	<b>67,000.2</b>
<b>Non-current liabilities</b>			
Interest-bearing bank and other borrowings	(2,325.1)	(727.4)	(3,568.5)
Defined benefit obligations	(1,569.0)	(1,437.5)	(1,233.0)
Provision for warranties	(733.4)	(972.2)	(1,147.3)
Government grants	(760.5)	(927.2)	(1,815.0)
Others	(125.5)	(104.8)	(210.8)
<b>Total non current liabilities</b>	<b>(5,513.5)</b>	<b>(4,169.0)</b>	<b>(7,974.6)</b>
<b>Net assets</b>	<b>28,087.9</b>	<b>39,509.9</b>	<b>46,154.6</b>
<b>Equity</b>			
Share capital	11,840.0	13,803.0	13,803.0
Reserves	8,237.1	17,710.2	21,514.6
Proposed final dividend & non-controlling interests	8,010.8	7,996.7	10,837.0
<b>Total equity</b>	<b>28,087.9</b>	<b>39,509.9</b>	<b>46,154.6</b>

Source: Company data

Figure 9: Cash flow statement (RMB m)

Operating activity	FY12/11	FY12/12	FY12/13
Profit before tax	5,442.1	5,592.7	5,933.5
Adjustments for:			
Interest income	157.7	232.3	170.3
Finance costs	1,029.8	764.4	546.4
Depreciation and amortisation	1,558.3	1,815.3	1,815.3
Loss on disposal	7.9	(3.7)	154.8
Others	(745.1)	(3,403.9)	(6,415.7)
Change of working capital	58.4	(4,764.8)	(2,034.3)
Cash generated from operations	7,351.4	3,017.2	6,209.9
Income tax paid	(567.8)	(854.8)	(968.4)
<b>Net cash flow from operating activities</b>	<b>6,941.3</b>	<b>2,394.7</b>	<b>5,411.9</b>
<b>Investing activities</b>			
Acquisition of prepaid land lease payments and subsidiary	(487.6)	(690.5)	(275.8)
Purchases of items of PP&E and others	(22,591.4)	(4,832.2)	(6,633.4)
Investments in jointly-controlled entities and associates	(11.0)	(276.7)	(295.7)
Proceeds from disposal of prepaid land lease payments	16,363.1	341.1	731.9
Decrease/(increase) in non-pledged deposits with original maturity	(1,053.9)	1,071.6	(851.4)
Others	237.7	141.1	79.1
<b>Net cash flow from investing activities</b>	<b>(7,543.1)</b>	<b>(4,245.6)</b>	<b>(7,245.3)</b>
<b>Financing activities</b>			
Repayment of bonds, bank and other borrowings	(28,895.9)	(27,604.9)	(33,329.9)
Distribution to shareholders	(473.6)	(2,484.5)	(1,242.3)
Bond issue expense	(36.0)	(9.8)	(1,019.8)
Interest paid	(930.7)	(969.8)	(544.9)
Proceeds from bank and issuance of bonds and issue of shares	39,200.7	25,194.4	35,177.3
Capital contributions from non-controlling shareholders	289.2	564.6	2,697.1
Others	(256.0)	(362.5)	(264.6)
<b>Cash flow from financing activities</b>	<b>8,897.7</b>	<b>(5,672.5)</b>	<b>1,473.1</b>
Net increase in cash and cash equivalent	8,295.9	(7,523.4)	(360.4)
Cash and cash equivalents at the beginning of the year	13,718.9	21,975.9	14,452.3
Effect of foreign rate exchange	(38.9)	(0.2)	(83.2)
<b>Cash and cash equivalents at the end of the year</b>	<b>21,975.9</b>	<b>14,452.3</b>	<b>14,008.7</b>

Source: Company data

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