

Opportunity from Smart Grid

BUY (unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	804.01,059.4	1,268.91,490.6	2,214.6		
Net Profit (RMBm)	212.9	261.5	286.9	323.3	508.0
EPS (RMB)	0.290	0.320	0.329	0.348	0.547
EPS Δ %	31.8	10.3	2.9	5.6	57.1
P/E (x)	8.9	8.1	7.9	7.5	4.7
P/B (x)	1.73	1.52	1.07	0.96	0.82
EV/EBITDA (x)	7.5	6.4	4.2	3.3	2.1
Yield (%)	2.9	3.3	3.3	3.7	5.8
ROE (%)	23.5	20.1	15.7	13.6	18.7
ROCE (%)	21.9	18.2	15.3	14.4	20.8
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2-Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-4.0	-3.4	+225.0
Actual price changes (%)	+2.0	+15.8	+261.0

	09F	10F	11F
Consensus EPS (RMB)	0.370	0.489	0.635
Previous forecasts (RMBm)	337.9	441.2	327.5
Previous EPS (RMB)	0.408	0.522	0.388

Price Chart



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improvement from present ~43m units each year. Meanwhile, we expect 25% enhancement in selling price for smart power metres compared with conventional ones (bull-case: 37.5%, bear-case: 12.5%). Thus, total investment on data collection systems in the ten years period will amount to RMB229.9b, equivalent to 5.7% of rumored China's aggregate RMB4,000b investment on the smart grid (bull-case: RMB290.6b and 7.3%, bear-case: RMB176.3b and 4.4%). Notably, some short-term slowdown is possible (mid-high single digit growth in 2009-2010), because major purchase will probably be held until release of relevant standards by 2010, which has been spotted in our channel checks.

Ticker:	3393.HK	12 mth range:	HK\$0.70-8.35
Price:	HK\$7.04	Market cap:	US\$838.4m
Target:	HK\$8.14 (+16%)	Daily t/o, 3 mth:	US\$6.3m
		Free float %:	45.2%

Key points:

- * "Strong Smart Grid" brought out in May.
- * Construction to start in 2011, lasting into 2020.
- * Estimated RMB229.9b investment on data collection systems for the ten years.
- * Short-term demand postponed.
- * Strengthened industry position by participating in formulating standards..
- * Satisfactory sales growth in 1H FY12/19A, implying market share expansion.
- * Scenarios re-defined with DCFE fair value at HK\$8.85 per share for the base case
- * Target at HK\$8.14.

Demand arising from smart grid construction. Chinese government unveiled its ambition in May with intention to build up a nationwide "Strong Smart Grid". Although details are yet to come, the State Grid Corporation of China (SGCC) has reportedly planed to complete construction by 2020 in three stages:

- Present-2010 – planning and trial stage: establishing technical standards, developing key equipments, testing and trial.
- 2011-2015 – mass construction stage: grid construction, establishing elementary system for power management and interactive service.
- 2016-2020 – improvement stage: completing construction of the nationwide smart grid.

During the construction, existing conventional power metres will be replaced by smart ones gradually. Taking into account the country's "One Household One Metre" policy and replacement period requirement contained in "Technical Administrative Code of Electric Energy Metering", which suggests a final holding volume of power metre in China at 400-500m units (present: ~230m units), we have re-constructed our industry scenarios. In the base-case scenario, total demand for power metres is projected at 741.7m units in 2011-2020 (bull-case: 833.3m, bear-case: 650.0m), representing an apparent

Table 1: Industry policies

Policies	Explanation	Implementation
"One household one metre"	Each individual household should equip its own power metre. There were total 373.4m household in China in 2007. 3-4 years for type I, II, III power metre, 4-6 years for type IV and 10 years for type V. Extension is possible subject to yearly assessment.	Assume the end holding volume is 450m for the base-case, 400m for the bear-case and 500m for the bull-case
Replacement period requirement		Assume an average replacement period of 6 years

Source: SBI E2-Capital

Table 2: Industry scenarios

Year to Dec (units m)	Sustainable holding volume	Demand for power metre										
		11F	12F	13F	14F	15F	16F	17F	18F	19F	20F	21F
Bear-case	400.0	44.5	51.2	58.8	67.7	77.8	70.0	70.0	70.0	70.0	70.0	66.7
Base-case	450.0	51.9	59.7	68.7	78.9	90.8	78.3	78.3	78.3	78.3	78.3	75.0
Bull-case	500.0	59.3	68.2	78.5	90.2	103.8	86.7	86.7	86.7	86.7	86.7	83.3

Source: SBI E2-Capital

Potential from making standards. Wasion captured ~8.7% market share in 2008 (three-phase: ~15%, single-phase: ~5% and data collection terminals: ~15%), which is likely to reach 10% this year based on growth in IH. We expect this market share expansion to persist, especially after commencement of smart grid construction, because the company has been chosen by China Electric Power Research Institute (CEPRI) as a first partner in developing electronic power metre, enabling the prior fully participate in formulating related technical standards, which will definitely strengthen Wasion's industry position. Accordingly, we have assumed a doubled market share for Wasion at 18.0% (three-phase: ~25%, single-phase: ~15% and data collection terminals: ~25%) by 2015. As the assumption on ending market share is critical in our valuation, we have done a thorough sensitivity analysis in table 4 with market share ranging from 13% (three-phase: ~20%, single-phase: ~10% and data collection terminals: ~20%) to 23% (three-phase: ~30%, single-phase: ~20% and data collection terminals: ~30%).

IH sales outperformed. By registering 19.1% top-line growth, Wasion outperformed other listing peers in IH backed by capacity expansion for three-phase metre and quick ramping-up of the newly acquired single-phase metre business. Thus, we expect the company's market share to improve to ~10% this year. Gross margin in IH narrowed slightly by 0.6pcp to 45.3%, which could be a mid-term trend given increasing contribution from single-phase product (gross margin: ~35% for single-phase and +50% for three-phase). Effective tax rate rose 5.4pcp to 11.4%. Net profit increased 10.5% to RMB73.3m.

Table 3: Peers comparison

Company	Ticker		Turnover (RMBm)	YoY change (%)	Gross profit (RMBm)	YoY change (%)	Op. profit (RMBm)	YoY change (%)
Wasion	3393	HK	411.7	19.1	186.3	17.5	91.2	15.3
Star Power	000676	CH	30.5	(48.2)	2.3	(88.4)	(28.3)	n.a.
Shenzhen Clou	002121	CH	142.5	5.1	64.3	19.6	23.7	123.0
Minovo - Power metre division	600873	CH	29.6	5.5	10.2	5.5	n.a.	n.a.

Source: Companies data

Target at HK\$8.05. The smart grid plan obviously has re-shaped industry outlook, in our view, from a short-term booming spurred by the economy stimulus package to a more sustainable and greater market prosperous, despite a temporary halt. We re-defined our scenarios. Accordingly, earnings forecast has been revised with major growth to come in FY12/I IF instead of previous FY12/09F. In the new base-case scenario, net profit will grow 8.4%, 11.4% and 57.9%, respectively, in FY12/09F-FY12/I IF. DCFE fair value is HK\$8.85 per share at end-09 and HK\$9.81 at end-10. We set our 12-month target price for the counter at HK\$8.14, which is at 15.0% discount to the time weighted average of the two fair values. BUY unchanged.

Table 4: Sensitivity (09 fair value under different market share assumption by 2015) (HK\$/share)

Scenario	13.0%	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%	22.0%	23.0%
Bear-case	6.10	6.35	6.60	6.85	7.11	7.36	7.61	7.86	8.11	8.36	8.62
Base-case	7.22	7.55	7.87	8.20	8.52	8.85	9.17	9.50	9.82	10.15	10.48
Bull-case	8.49	8.90	9.31	9.71	10.12	10.53	10.94	11.35	11.76	12.17	12.58

Source: SBI E2-Capital

Table 5: P & L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	804.0	1,059.4	1,268.9	1,490.6	2,214.6
Cost of sales	(425.1)	(561.8)	(683.4)	(818.3)	(1,206.2)
Gross profit	378.9	497.6	585.5	672.4	1,008.4
Other revenue	28.6	23.1	9.0	9.5	10.0
Administrative expenses	(70.5)	(93.5)	(101.8)	(116.4)	(156.5)
Selling expenses	(68.5)	(92.0)	(99.0)	(116.3)	(172.7)
Research and development expenses	(17.8)	(29.7)	(48.2)	(56.6)	(84.1)
Operating profit	250.6	305.5	345.5	392.6	605.0
Loss on disposal of available-for-sale investment		(3.1)			
Finance costs	(17.2)	(19.6)	(20.5)	(24.3)	(13.3)
Profit before taxation	233.4	282.9	325.0	368.3	591.7
Income tax expenses	(20.5)	(21.3)	(39.0)	(49.7)	(88.8)
Net profit	212.9	261.5	286.0	318.6	502.9

Source: Company data, SBI E2-Capital

P & L (RMBm)	07A	08A	09F	10F	11F	Cash Flow (RMBm)	07A	08A	09F	10F	11F
Year to Dec						Year to Dec					
Turnover	804.0	1,059.4	1,268.9	1,490.6	2,214.6	EBIT	243.1	300.9	340.5	387.1	599.0
% chg	33.9	31.8	19.8	17.5	48.6	Depre./amort.	36.9	70.1	85.8	101.0	100.3
Gross profit	378.9	497.6	585.5	672.4	1,008.4	Net int. paid	(10.1)	(26.4)	(14.5)	(13.3)	(1.3)
						Tax paid	(6.9)	(14.7)	(35.1)	(43.1)	(64.2)
EBITDA	280.1	371.1	426.3	488.0	699.3	Dividends received					
Depre./amort.	(36.9)	(70.1)	(85.8)	(101.0)	(100.3)	Gross cashflow	263.1	330.0	376.7	431.6	633.8
EBIT	243.1	300.9	340.5	387.1	599.0						
Net int. income/(exp.)	(9.7)	(15.0)	(14.5)	(13.3)	(1.3)	Chgs. in working cap.	(199.1)	(59.0)	(104.7)	(108.5)	(374.3)
Exceptionals		(3.1)				Operating cashflow	63.9	271.0	271.9	323.2	259.4
Associates											
Jointly-controlled entit.						Capex	(180.0)	(312.9)	(142.9)	(31.0)	(46.2)
Pre-tax profit	233.4	282.9	326.0	373.8	597.7	Free cashflow	(116.1)	(41.8)	129.1	292.2	213.3
Tax	(20.5)	(21.3)	(39.1)	(50.5)	(89.7)						
Minority interests	0.0	0.0	0.0	0.0	0.0	Dividends paid	(49.3)	(66.9)	(90.2)	(89.9)	(101.3)
Net profit	212.9	261.5	286.9	323.3	508.0	Net distribution to MI					
% chg		22.8	9.7	12.7	57.1	Investments					
						Disposals					
Dividends	(49.3)	(66.9)	(90.2)	(89.9)	(101.3)	New shares	483.0	0.0	670.0	0.0	0.0
Retained earnings	163.6	194.7	196.7	233.4	406.7	Change in loans					
						Others	(44.3)	(172.0)	(60.8)	9.8	14.5
EPS (RMB) - Basic	0.290	0.320	0.329	0.348	0.547	Net cashflow	273.4	(280.7)	648.1	212.1	126.5
EPS (RMB) - F.D.	0.280	0.310	0.329	0.348	0.547						
DPS (RMB)	0.084	0.097	0.097	0.109	0.171	Net (debt)/cash - Beg.	66.0	339.3	58.7	706.8	918.8
No. sh.s o/s (m) - W.A.	734.8	814.8	871.0	929.5	929.5	Net (debt)/cash - End.	339.3	58.7	706.8	918.8	1,045.3
No. sh.s o/s (m) - Y.E.	816.9	812.6	929.5	929.5	929.5						
No. sh.s o/s (m) - F.D.	752.1	837.7	871.0	929.5	929.5						
Margins (%)						Interim Results (RMBm)	07A	08A	09A		
Gross	47.1	47.0	46.1	45.1	45.5	Six months to Jun					
EBITDA	34.8	35.0	33.6	32.7	31.6	Turnover	291.7	345.5	411.7		
EBIT	30.2	28.4	26.8	26.0	27.0	% chg		18.4	19.1		
Pre-tax	29.0	26.7	25.7	25.1	27.0						
Net	26.5	24.7	22.6	21.7	22.9	Profit from operations	67.9	79.1	91.2		
						Interest expenses	(6.9)	(8.4)	(8.4)		
						Associates					
						Jointly-controlled entit.					
						Pre-tax profit	61.0	70.7	82.8		
						Tax	(2.0)	(4.3)	(9.5)		
						Minority interests	0.0	0.0	0.0		
						Net profit	59.1	66.4	73.3		
						% chg		12.4	10.5		
						EPS (RMB) - Basic	0.084	0.081	0.089		
						DPS (RMB)					
Balance Sheet (RMBm)	07A	08A	09F	10F	11F	Shareholding Structure					
Year to Dec									Shares o/s (m)	%	
Fixed assets	231.3	532.9	642.6	625.4	624.0	Ji Wei			466.9	50.3	
Intangible assets	259.0	358.3	305.6	252.9	200.2	Public			462.1	49.7	
Other LT assets	0.0	5.0	5.0	5.0	5.0	Total			929.0	100.0	
Cash	590.1	512.8	1,066.4	1,158.7	1,133.3						
Accounts receivable	604.0	766.6	918.2	1,078.6	1,602.5						
Other receivables											
Inventories	149.9	255.6	310.9	372.3	548.8						
Due from related co.s	80.2	110.7	0.0	0.0	0.0						
Other current assets	1.0	2.1	2.1	2.1	2.1						
Total assets	1,915.6	2,543.8	3,250.7	3,494.9	4,115.8						
Accounts payable	(277.2)	(472.1)	(574.3)	(687.6)	(1,013.7)	Background					
Other payable						Wasion is a leading manufacturer of electricity data collection products in China. Headquartered in Changsha, the company employs over 2,500 staffs and has set up a national sales / service network (2005: 25 liaise offices). Major products include three-phase power metre, single-phase power metre, data collection terminals and power management software.					
Tax payable	(12.8)	(21.5)	(25.4)	(32.8)	(58.3)						
Due to related co.s	(129.6)	(179.8)	0.0	0.0	0.0						
ST debts	(208.8)	(234.1)	(183.6)	(107.9)	0.0						
Other current liab.											
LT debts	(42.0)	(220.0)	(176.0)	(132.0)	(88.0)						
Other LT liabilities	(21.9)	(31.2)	(31.2)	(31.2)	(31.2)						
Total liabilities	(692.3)	(1,158.7)	(990.6)	(991.5)	(1,191.2)						
						Key Ratios	07A	08A	09F	10F	11F
Share capital	8.4	8.4	9.6	9.6	9.6	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Reserves	1,214.9	1,376.7	2,250.6	2,493.8	2,915.1	Net ROE (%)	23.5	20.1	15.7	13.6	18.7
Shareholders' funds	1,223.3	1,385.1	2,260.2	2,503.4	2,924.6	EBIT ROCE (%)	21.9	18.2	15.3	14.4	20.8
Minority interest	-	-	-	-	-	Dividend payout (%)	3.2	3.7	3.7	4.2	6.6
Total	1,223.3	1,385.1	2,260.2	2,503.4	2,924.6	Effective tax rate (%)	8.8	7.5	12.0	13.5	15.0
						Net interest coverage (x)	24.9	20.0	23.5	29.1	460.8
Capital employed	1,474.1	1,839.2	2,619.8	2,743.3	3,012.6	A/R turnover (days)	226.4	236.1	242.3	244.5	220.9
Net (debt)/cash	339.3	58.7	706.8	918.8	1,045.3	A/P turnover (days)	102.6	129.1	150.5	154.5	140.2
						Stock turnover (days)	110.1	131.7	151.3	152.4	139.4

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