

Wasion

It's time for change

to summarize...

- Growth in FY12/09A was under double pressure: reduced domestic demand as SGCC postponed purchase and weak overseas market.
- Domestic demand is expected to pick up in 2010 after SGCC resumed procurement in Dec 09.
- Centralized procurement programme will likely favour Wasion's market occupancy at expense of gross margin.
- FY12/09A results are in line. Estimates were amended slightly.
- Target price stays at HK\$5.75. Downgrade to HOLD as share price approached target.
- SGCC's second round bidding results will be a major catalyst.

Growth slowed down on delayed grid procurement. The electricity power metre industry experienced a weak year in 2009. Sate Grid Corporation of China (SGCC) halted its procurement in 2H, awaiting standards for smart metre, which significantly reduced its purchase volume during the year. Meanwhile, overseas demand contracted amid the post-crisis recession. Thus, we see considerable slow-down in Wasion's top-line growth, from 31.8% last year to 1.8% in FY12/9A. Blended gross margin narrowed 2.0pcp to 45.0% while operating margin 2.3pcp to 26.5%. Net profit edged up 0.2% to RMB262.0m (our estimate: RMB259.2m).

Table 1. Reven and gross margin change

Year end Dec	08A	09A	YoY change (%)
Revenue	1,059.4	1,078.2	1.8
Three-phase	460.7	471.5	2.3
Single-phase	265.4	284.0	7.0
DCTs and related services	275.0	249.7	(9.2)
Water, gas and heat metre	58.3	73.1	25.3
			(pcp)
Gross margin (%)	47.0	45.0	(2.0)
Three-phase	54.0	50.0	(4.0)
Single-phase	35.0	33.0	(2.0)
DCTs and related services	51.0	47.0	(4.0)
Water, gas and heat metre	39.0	37.0	(2.0)

Source: Company data

Overall demand is expected to recover to 56.6m units in 2010. SGCC released the smart metre standards and initiated its centralized procurement programme in Dec last year. Consequently, its demand is anticipated to return "normal". Wasion estimated that SGCC's total purchase could reach 33m units this year. Together with demand from China Southern Grid (CSG) (procurement size is usually 1/5-1/4 of SGCC's) and clients in corporate and retail sectors (15-20m units each year), China's overall market size of power metre in 2010 will be 54.6-61.3m units. Our estimate is 56.6m units unchanged (2009: 40-45m units)

Ticker	3393 HK
Rating	HOLD
Price (HK\$)	5.50
Target Price (HK\$)	5.75 (+5%)
12m Price Range (HK\$)	2.49-8.65
Market cap. (US\$m)	655.6
Daily t/o (US\$m)	4.9
Free float (%)	45.0

Financial summary

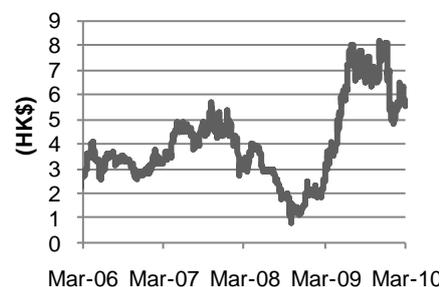
Year to Dec	08A	09F	10F	11F	12F
Turnover (RMBm)	1,059.4	1,078.2	1,754.3	2,331.0	2,810.9
Net Profit (RMBm)	261.5	262.0	343.7	411.1	456.3
EPS (RMB)	0.320	0.310	0.369	0.439	0.485
P/E (x)	15.1	15.5	13.1	11.0	9.9
P/B (x)	2.83	2.09	1.86	1.64	1.46
EV/EBITDA (x)	11.2	11.7	8.5	7.1	6.3
Yield (%)	2.0	2.0	2.3	2.7	3.0
ROE (%)	14.8	11.5	13.3	14.0	13.7
ROCE (%)	13.7	10.3	12.7	13.4	12.9
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2-Capital

	10F	11F	12F
Consensus EPS (RMB)	0.366	0.433	0.505
Previous earnings (RMBm)	343.8	409.8	n.a.
Previous EPS (RMB)	0.369	0.437	n.a.

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-4.0	-30.2	+40.1
Actual price changes (%)	-1.1	-32.2	+119.1



Source: Bloomberg

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Table 2. Assumption on China's power metre market size

Year end Dec (units m)	10F	11F	12F	13F	14F	15F
Grid	41.6	46.5	51.4	56.3	68.7	75.7
Non-grid	15.0	15.0	15.0	15.0	15.0	15.0
Total	56.6	61.5	66.4	71.3	83.7	90.7

Source: SBI E2-Capital

Gross margin is under pressure, though market share will improve. Despite the expected increase in market size, we reiterate our concern on gross margin side with reference from telecom equipment industry. We reckon that power metre manufactures can lose 10-15pcp in their gross margin under SGCC's centralized procurement policy and associated open bidding. Wason intends to soften this potential effect by boosting sales to non-grid clients including corporate, retail and overseas. Nevertheless, we think the smart grid construction is government-oriented. Grid companies' demand will be the major organic driver for the power metre industry. Hence it might not be easy for Wason to achieve a more balance client mix in short term (grids accounted for 71% of total revenue in FY12/09A). On the good side, however, the centralize procurement will accelerate industry consolidation and phase out small players. Thus, we can rationally assume gradually improving market occupancy for Wason in long term.

Table 3. Gross margin assumption

Year end Dec (%)	10F	11F	12F	13F	14F	15F
Three-phase metre	42.5	40.0	38.5	37.5	37.5	37.5
Single-phase metre	35.0	32.5	31.0	30.0	30.0	30.0
DCTs and related services	42.5	40.0	38.5	37.5	37.5	37.5
Water, gas and heat metre	38.0	38.0	38.0	38.0	38.0	38.0
Three-phase metre	42.5	40.0	38.5	37.5	37.5	37.5

Source: SBI E2-Capital

Seeable catalyst comes from second round bidding. The FY12/09A results are broadly in line. We only fine tuned our estimates. SGCC's second round bidding results could be a major catalyst in short term, which may also provide us more clues about future market trend in terms of both market share and gross margin. We will update our recommendation thereafter. For time being, we maintain our target price at HK\$5.75 unchanged. The share price rose from HK\$5.09 when our last update (**Margin pressure from centralized procurement, but over-sold**, 8th Feb 10) was issued to present HK\$5.50, which is only 4.3% below our target. Accordingly, we change our recommendation from BUY to HOLD.

Table 4. P&L

Year end Dec (RMBm)	08A	09A	10F	11F	12F
Turnover	1,059.4	1,078.2	1,754.3	2,331.0	2,810.9
Cost of sales	(561.8)	(592.9)	(1,053.1)	(1,454.8)	(1,799.9)
Gross profit	497.6	485.3	701.2	876.3	1,011.0
Other revenue	23.1	13.8	18.9	27.6	33.7
Administrative expenses	(93.5)	(91.8)	(127.2)	(153.0)	(166.0)
Selling expenses	(92.0)	(90.4)	(149.1)	(198.1)	(238.9)
Research and development expenses	(29.7)	(30.9)	(43.0)	(69.2)	(97.0)
Operating profit	305.5	286.0	400.8	483.5	542.9
Loss on disposal of available-for-sale investment	(3.1)	0.0	0.0	0.0	0.0
Finance costs	(19.6)	(14.3)	(16.8)	(24.2)	(33.0)
Profit before taxation	282.9	271.7	384.0	459.3	509.9
Income tax expenses	(21.3)	(9.7)	(40.3)	(48.2)	(53.5)
Profit for the period	261.5	262.0	343.7	411.1	456.3
Attributable to:					
Equity holders of the Company	261.5	262.0	343.7	411.1	456.3
Minority interests	-	-	-	-	-
EPS - Basic (RMB)	0.320	0.310	0.369	0.439	0.485
EPS - Diluted (RMB)	0.310	0.300	0.363	0.432	0.478
Proposed DPS (RMB)	0.097	0.097	0.110	0.131	0.145
Proposed dividend	81.9	81.9	103.1	123.3	136.9

Source: Company data, SBI E2-Capital

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