

## China railway play

## China Electronics

### Zhuzhou CSR Times Electric (3898 HK)

Not Rated

**Table 1: Offer statistics**

Offer price range	HK\$4.18 - 5.30
No. of share offered	360.56m
Fund raised	HK\$1,507m – 1,911m
Offer P/E (FY2006F)	11x - 15x
Market cap	US\$194m - 246m
IPO opens	8-Dec-06
IPO closes	13-Dec-06
Price determination	14-Dec-06
Listing	20-Dec-06

Source: Company data

**Company background.** Zhuzhou CSR Times Electric (“CS RTE”) provides and integrates train-borne electrical system for the PRC railway industry. It is also engaged in developing, manufacturing and selling train power converters, auxiliary power supply equipment and control systems for trains for urban rail systems. CS RTE also designs, manufactures and sells electrical components for the PRC railway industry, the urban rail industry and non-railway applications. Its key customers are the Ministry of Rail (MOR), railway administrations, rail vehicle manufacturers and urban rail system operations in the PRC.

**Products.** CS RTE’s train-borne electrical systems are used in locomotives, passenger cars, trains for urban rail systems and large railway maintenance vehicles. Its electrical components are used as components in train-borne electrical systems in railway industry, and they are also used as power transmission, metal processing, mining and chemical engineering.

**Table 2: Products categories**

Categories	Products
<b>Train-borne Electrical Systems</b>	<input type="checkbox"/> Train power converters, auxiliary power supply equipment and control systems <input type="checkbox"/> Train operation safety equipment <input type="checkbox"/> Electrical control systems for large railway maintenance vehicles
<b>Electrical components</b>	<input type="checkbox"/> Power semiconductor devices <input type="checkbox"/> Sensors and related products <input type="checkbox"/> PCBs and low inductance busbars for train-borne electrical systems

Source: Company data

**Market share.** In 2005, CS RTE’s major products, train power converters and control systems accounted for 40% and 69% of the market respectively. Train operation safety equipment, electrical control system for large railway maintenance vehicles and power semiconductor devices accounted for approximately 63%, 100% and 51% in the domestic rail vehicle market respectively.

**Railway industry overview.** The growth of the China railway industry is very much dependent on the economic growth in China. The continuous growth of the country’s economy and urbanisation will boost the demand for freight and passenger railway transportation. The MOR will continue to construct new railways lines and upgrade the existing lines to meet the increasing demand for railway transportation. According to MOR’s Eleventh Five-year plan, the demand for trains for urban rail systems is expected to be c. 2,500 to 3,000 by 2010. In the past, most of the vehicles used in PRC rail line were imported. But in 1999, the PRC Government required

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an average of not less than 70% of the rail vehicles and related equipments (measured by value used in each railway projects) must be sourced within the PRC.

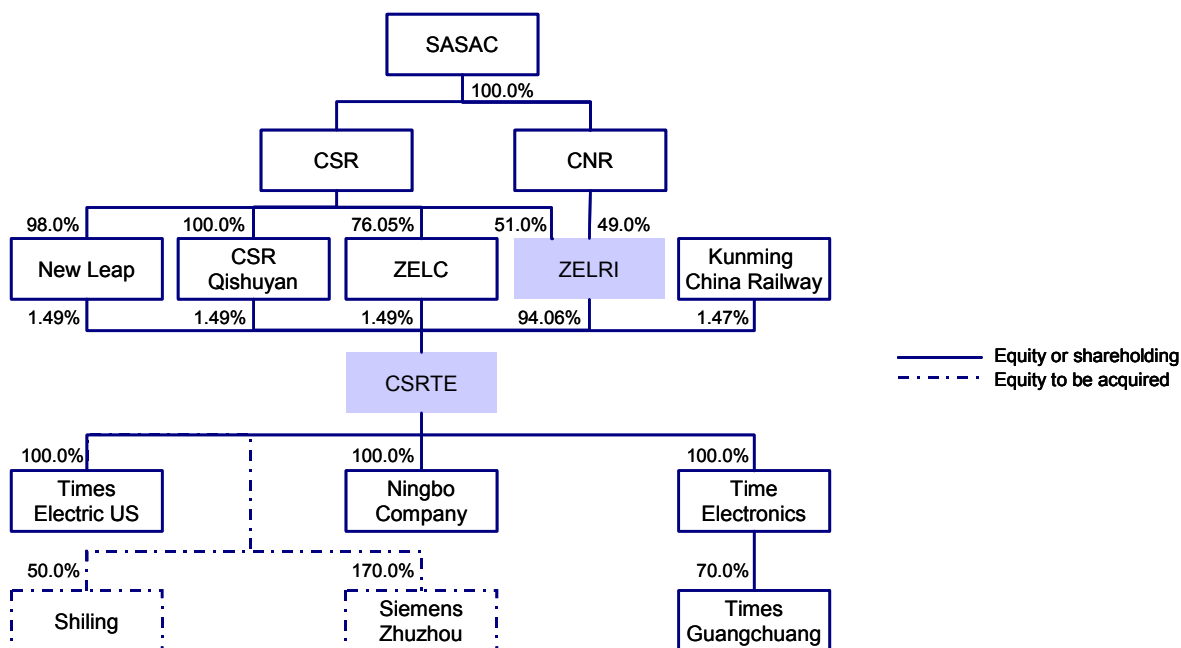
**Expand to international markets.** Going forward, CSRTE wants to expand its business to overseas markets. The company has signed a 3-years contract with General Electric Company to supply all of its requirements for four types of power semiconductor. This year, CSRTE established a subsidiary company in US to explore more opportunities in overseas markets. Currently, sales from overseas only accounted for 7-8% of its turnover.

**Our views.**

- ❑ **Relationship with MOR.** MOR is a government body overseeing the PRC railway industry, it is responsible for formulating and implementing the overall strategies and polices for the railway industry. In the past, CSRTE’s parent company (CSR Zhuzhou Electric Locomotive Research Institute) undertook R&D of locomotives and related products together with MOD, thus CSRTE has close bond with the MOD. But if the relationship with MOR weakens, this will have adverse effect on CSRTE’s business. Therefore, a close bond with MOR is vital in determining the success of its business.
- ❑ **In-house sourcing.** Some of the key customers are trying to develop systems that CSRTE is currently supplying. Once they obtain approval from MOD to develop those systems, they will terminate their need of the CSRTE’s products. CSRTE’s turnover would be greatly affected.
- ❑ **Competition is getting more intense.** In late 2004, MOR started to use imported products and technologies. As a result, competition in this industry is expected to become more intense going forward. Besides, the technology used by CSRTE is not as advanced as that used by the foreign rivals.
- ❑ **AR turnover days are relatively long.** Regardless when CSRTE delivers the products to its customers, MOR and local railway administrations will only pay CSRTE when they receive fund from the local governments which normally will be settled at the of season or year-end. Thus, CSRTE has relatively long AR turnover days.

**Valuation.** The stock will be priced at 11-15x FY12/06F P/E, which is less demanding than Xiangtan Electric’s (600416CH, RMB9.64, NR) current P/E of c.30.8x but is higher compared to MTR Corporation’s (66HK, HK\$19.34, NR) current P/E of 9.61x.

**Chart 1: Group structure**



Note: ZELRI – CSR Zhuzhou Electric Locomotive Research Institute  
 SASAC – Assets Supervision and Administration Commission of the State Council  
 CSR – China Southern Locomotive and Rolling Stock Industry (Group) Corporation  
 CNR – China Northern Locomotive and Rolling Stock Industry (Group) Corporation  
 ZELC – CSR Zhuzhou Electric Locomotive Company Ltd

Source: Company data

**Table 3: Use of proceeds**

	HK\$m
Train power converter auxiliary power supply equipment and control systems	665
Train safety operation equipment	174
Develop a new generation of railway maintenance vehicles	35
Large size power semiconductor devices	361
Sensors and related products	118
Establish an export and overseas sales network	40
Establish information system (including ERP system)	63
Acquire Zhuzhou Shiling Transportation Equipment Company	60
Acquire Siemens Trancion Equipment Limited	12

Source: Company data

**Table 4: Profit and loss**

Year to Dec (RMBm)	03A	04A	05A
Turnover	658.8	787.8	998.0
COGS	(388.4)	(464.7)	(542.3)
Gross profit	270.4	323.1	455.7
Other income	14.4	86.1	18.5
Selling and distribution expenses	(41.8)	(58.9)	(87.3)
Administratioin expenses	(155.6)	(161.7)	(154.8)
Other revenue/(expenses)	(0.8)	(1.1)	0.3
Profit from operating activities	86.6	187.5	232.4
Finance costs	(8.1)	(10.8)	(13.8)
Share of profit of associates	17.9	8.3	-
Profit before tax	96.4	185.0	218.6
Tax	-	(2.6)	(0.6)
Net profit before minority interest	96.4	182.4	218.0
Attributable to:			
Equity holders	98.5	162.7	211.7
Minority interests	(2.1)	19.7	6.2
EPS-basic (RMB)	0.16	0.26	0.33

Source: Company date