

# Smart Grid in China

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## Sector Report

### Assemble parts into a whole

**Reaping the upcoming 13<sup>th</sup> Five Year Plan theme on energy savings investment in China. Prefer Energy management contracting (EMC) > Energy solution provider > Ultra High Voltage (UHV) Power Grid Construction.** Upon success of pilot scheme, energy savings investment will shift from industrial to public facilities, which is driven by urbanization in China, stricter government policy and rising energy cost, we expect the energy management (EM) industry market to grow at 22% CAGR in 2012-2015E. Thanks to supporting government policies, we expect energy management contract (EMC) will enjoy fastest growth as subset of EM industry, at CAGR 39% in 2013-2015E. Our top pick in EMC is Technovator (1206 HK) which started EMC business last year and we believe the company will continue to grow organically and asset injection from mother company. We lower our TP from \$5.25 to \$4.3 to reflect share dilution, however we expect TargetCo. to breakeven in FY14E, we haven't take into account of the profit enhancement from FY15E onwards yet. We also like Boer Power (1685 HK), which is utilizing its customer base from power distribution business to step into EM industry, currently focusing on data centers.

**Smart meters penetration likely to approach 100% nationwide in China from current average 60% and replacement demand on smart meter is likely to kick off from FY15E onwards, which drive Wasion Group (3393 HK) earnings CAGR 22% in FY13-16E.** After the centralized tender process was slowed down in 2013 and recently by the ongoing anti-graft action, we believe dislocations have been cleared and business is likely speed up from 2014E onwards. Our top pick is Wasion (3393 HK) which (1) showed its capabilities in maintaining its hold on the No. 1 market share in a resurgent smart meter market and (2) Widening margin driven by expanding business from Advance Metering Infrastructure (AMI) to Advanced Distribution Operations (ADO) via M&A. We initiate our NEW BUY rating on Wasion with TP HK\$8.3, representing 13x FY14E PE and 34% upside potential.

**Accelerating growth on Ultra High Voltage (UHV) power cables at 62% CAGR in 2015E – 2020E as compared to 18% in 2010-2015E,** driven by National Energy Administration's (NEA)'s plan to construct long distance UHV (800-1,000kV) overhead power grid. We believe demand for Extra High Voltage (EHV, 330-800kV) power cables used in regional underground power distribution will be boosted with voltage upgrade driven by construction of UHV power grids. We like Jiangnan Group (1366 HK) as a potential beneficiary of the accelerating growth of power cable demand driven by NEA's plan and, we believe, Jiangnan is likely also to fuel its growth via M&A to penetrate into high-end products. We recommend BUY rating on Jiangnan with TP HK\$2.4 representing, 9x FY14E PE, 14% upside potential.

#### Exhibit 1: Recommendations summary

Company	Stock code	Rating	Target Price	Closed Price	Upside (%)
Wasion Group	3393	BUY	8.3	6.18	+34%
Technovator	1206	BUY	4.3	3.6	+20%
Jiangnan Group	1366	BUY	2.4	2.1	+14%
Boer Power	1685	BUY	10.8	9.45	+14%

Source: Bloomberg, OP Research

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## Investment summary

### Reaping the upcoming 13<sup>th</sup> Five Year Plan theme on energy savings investment in China. Prefer Energy Management Contracting (EMC) > Energy solution provider > UHV construction

1. First of all, we believe energy savings investment will shift from industrial to public facilities, driven by urbanization in China which is the focus of China's smart grid development. As one of the central government's key aims, we expect the Energy Management (EM)'s market size to achieve 22% CAGR in 2012-2015E.
2. In light of this, leading Energy management contract (EMC) companies will enjoy fastest growth as subset of EM industry, at 39% CAGR in 2013-2015E, thanks to supporting government policies for EMC companies such as exemption on corporate tax, subsidies on building retrofit, etc.
3. We also expect the penetration of smart meters to increase rapidly from the current 60% in China to approaching 100%. Besides, we also see replacement demand kick in to drive 4.8% CAGR in 2013-2020E, starting in 2015E.
4. As smart meter penetration is likely to reach full coverage from 2014E onwards, we believe that smart meter suppliers with tailor-made power distribution and energy efficient solutions are able to leverage on the well-established smart meter network to offer value-added service, hence new revenue flow to support its robust earnings growth in the coming five years, we expect the earnings CAGR of Wasion Group (3393 HK) is 20% in 2013-2016E.
5. Ultra High Voltage (UHV) power cables demand CAGR 62% in 2015E-2020E, is much higher than CAGR 18% in 2010-2015E, thanks to National Energy Administration(NEA)'s plan for long distance power grid construction,
6. High entry barrier enable market consolidation. Nationwide UHV grid construction drives demand in EHV power cables construction in regional power distribution, only 12 manufacturers are qualified as suppliers to SGCC.

### Riding on opportunities of integration between midstream and downstream. Top pick Wasion Group (3393 HK, BUY, TP HK\$8.3) and Technovator (1206 HK, BUY, TP HK\$4.3).

1. The midstream (smart meters and power distribution) and downstream industry (energy management) share similar customer base and similar automation technology, we believe the higher gross margin in downstream industry will attract vertical integration.
2. Our sector top picks are Wasion Group (3393 HK) and Technovator (1206 HK). We like Wasion Group since it is the domestic market leader of smart meters, their acquisitions to complete power distribution will kick off margin expansion, we believe they are able to leverage on their well-established network. Meanwhile, Technovator is domestic market leader in building energy savings, with expanding business in energy savings in power generation, we believe its strong R&D ability, improving brand recognition and ongoing asset injections are their strong points on which to build up an enterprise with complete value chain in energy savings.

**Who are winners? Bigger and stronger**

	<b>Technovator (1206 HK, BUY)</b>	<b>Jiangnan Group (1366 HK, BUY)</b>
<b>Principal sub-sector</b>	Energy savings	Power cables
<b>Domestic Leader of</b>	Integrated Building automatic system (iBAS)	Power cables
<b>Recent M&amp;A (sub-sector)</b>	Tongfang Energy Saving Engineering Technology (Energy savings)	Jiangsu Zhongmei Cable (Rubber power cables)
<b>3 yrs earnings CAGR</b>	32%	19%
<b>Gross Profit Margin</b>	37.0%	15.4%
<b>Recommendation</b>	BUY	BUY
<b>TP</b>	HK\$4.30	HK\$2.4
<b>Target FY14E PE</b>	12x	9x

	<b>Boer Power (1685 HK, BUY)</b>	<b>Wasion Group (3393 HK, BUY)</b>
<b>Principal sub-sector</b>	Power distribution, energy savings	Smart meter
<b>Domestic Leader of</b>	Power distribution	Smart meter
<b>Recent M&amp;A (sub-sector)</b>	-	1) Hunan Switchgear; 2) Wuhan Smart Electrical (Power distribution)
<b>3 yrs earnings CAGR</b>	19%	22%
<b>Gross Profit Margin</b>	36.0%	35.1%
<b>Recommendation</b>	BUY	BUY
<b>TP</b>	HK\$10.8	HK\$8.3
<b>Target FY14E PE</b>	15x	13x

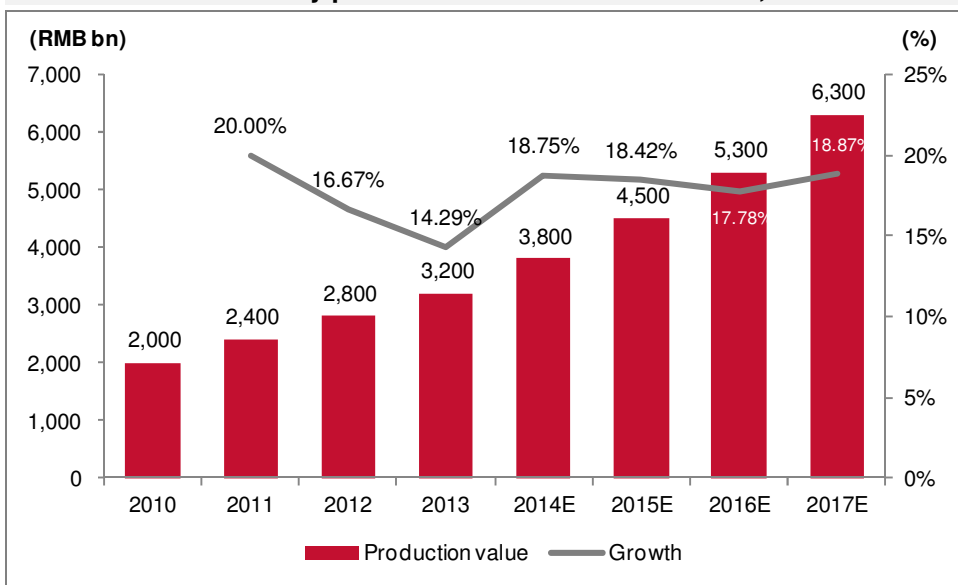
Source: OP Research

## Energy savings is the top priority goal in the coming five years in China

### Policy support on EMC to activate society's capital

An important feature of Smart Grid is using power efficiently, minimizing energy waste, thus protecting the environment. During China's 12<sup>th</sup> Five Year Plan, CAGR of energy savings and environmental protection (ESEP) industry is 15% or above, total production value up to RMB4,500bn in 2015E from RMB2,000bn in 2010E.

**Exhibit 2: ESEP industry production value will reach RMB6,300bn in 2017**



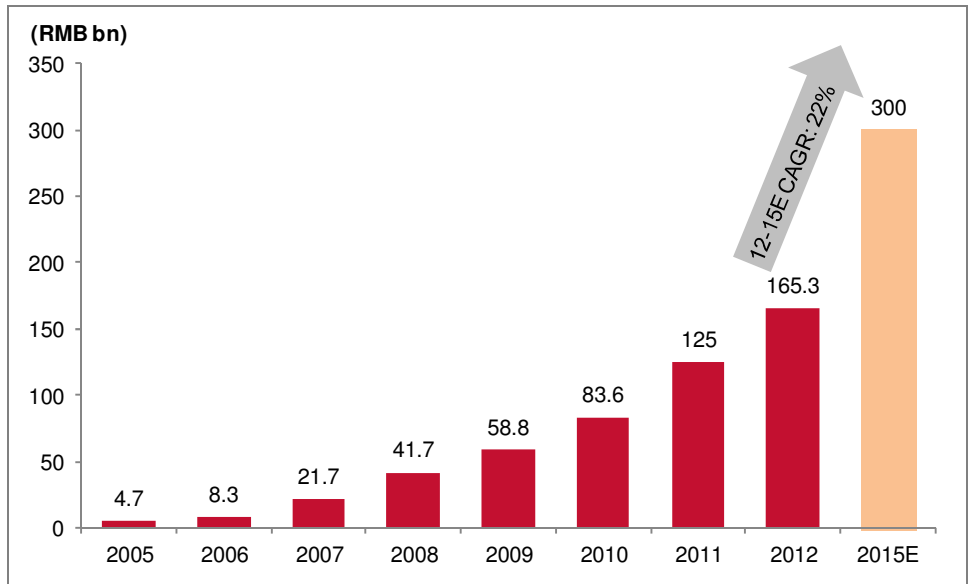
Source: Chinabgao, OP Research

### Introducing society capital

In August 2013, the State Council of PRC unveiled a follow-up document "Speed up the development energy savings and environmental protection industry". This encouraged users to utilize "Energy Savings Doctor", through energy management contract (EMC) to improve energy efficiency. It said government would play a leading role in introducing society capital into energy savings, wherever EMC provides a suitable model to achieve the goal.

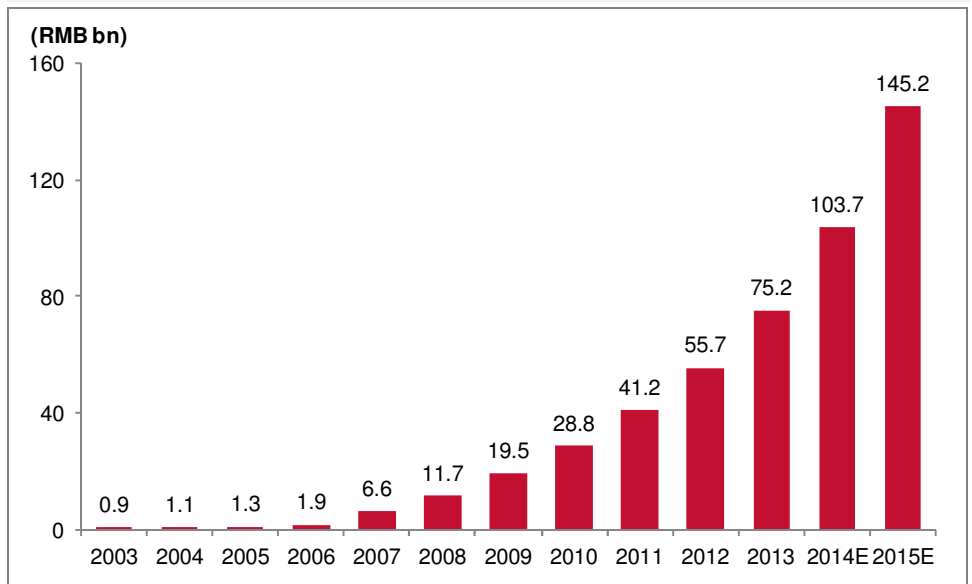
According to ESCO Committee of China Energy Conservation Association (EMCA), China's energy management industry has enjoyed 35x growth from 2005 to 2012, CAGR 66%, EMCA forecast the total market size will reach RMB300bn in 2015E. In addition, the proportion of EMC in EM industry is quite stable at around 20%~30% in the past. With active government support in China, we expect the proportion will expand; a research report from Zhiyan Consulting Group forecast relevant growth at 35%/37.9%/40% in 2013/2014E/2015E respectively, a huge leap from RMB55.7bn in 2012 to RMB145.2bn in 2015. We believe Technovator (1206.HK) will be a direct beneficiary to reap this robust growth.

**Exhibit 3: Energy management turnover growth exponentially**



Source: EMCA, OP Research

**Exhibit 4: Total EMC revenue increased by 35% in 2013**

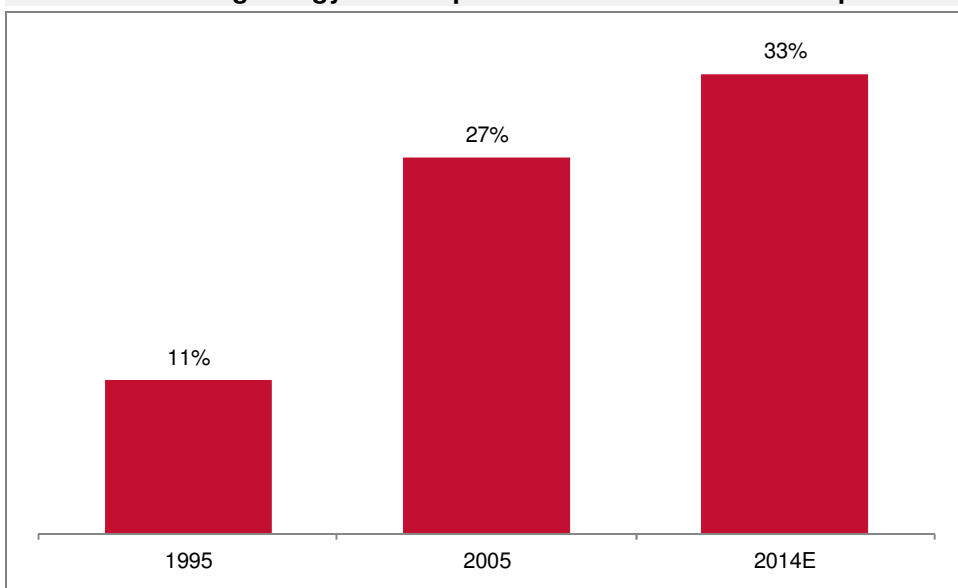


Source: EMCA, OP Research

### Domestic brand catching up in green buildings

The state council set a target for new green buildings area to be 1bn square meters or above in 2015E, accounting for 20% of total new Gross Floor Area (GFA) constructions in China's urban areas, and further raising to 50% by 2020E, a great leap up from the 2% of 2012. The central government has vaulting ambitions, listing gains in energy savings as one of the evaluation of political leadership, thus providing a great motivation for local governments to seriously implement relevant policies. In fact, the percentage of domestic energy consumption in the total national consumption is estimated to exceed 30% this year, a matter of rising concern for the central government.

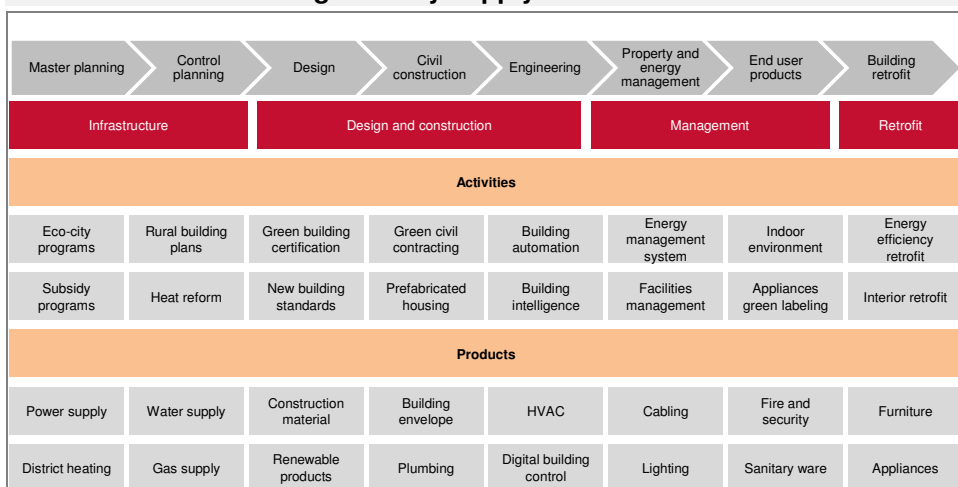
**Exhibit 5: Building energy consumption as % of national consumption**



Source: EMCA, OP Research

Green buildings supply chain involves four main stages: 1) infrastructure, 2) design and construction, 3) management and 4) retrofit.

**Exhibit 6: Green building industry supply chain**



Source: CGTI analysis, OP Research

**Domestic brand catching up**

Current intelligent building automation systems (iBAS) market leaders in China are Siemens and Honeywell, but domestic brands are catching up, Technovator (1206 HK) won the 3rd place among global competitors in 2014 April, which is the first time a domestic brand has been ranked among the Top 3 since 2009. Among the Top 10 there are other domestic players like SUPCON and Shanghai Great.

We believe recognition of domestic brands is on the rise with the success of pilot projects in 1st –tier cities. The successful, responsible brand will have the advantage in future promotions and nationwide implementation.

Exhibit 7: 2014 April top 10 iBAS provider in China		
1 <sup>st</sup>	<b>SIEMENS</b>	2 <sup>nd</sup> <b>Honeywell</b>
		3 <sup>rd</sup> <b>Techcon</b>
4 <sup>th</sup>	<b>Schneider Electric</b>	5 <sup>th</sup> <b>Johnson Controls</b>
		6 <sup>th</sup> <b>Delta</b> ™ CONTROLS
7 <sup>th</sup>	<b>ASI</b>	8 <sup>th</sup> <b>SUPCON</b>
		9 <sup>th</sup> <b>GREAT</b> ® 格瑞特
10 <sup>th</sup>	<b>BECKHOFF</b>	

Source: Qianjia, OP Research



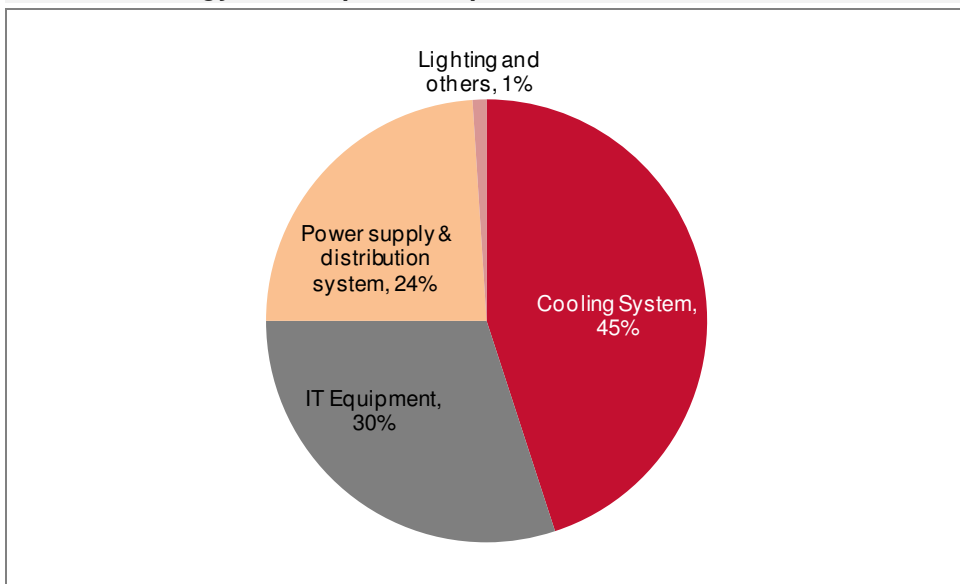
**Data Center is a big tiger driven by increasing penetration of internet users in China**

Make-over of energy savings system in data center is another big tiger, which focus at reducing energy usage of cooling systems in data centers, supercomputing centers and mainframe computer, which account for 45% of total energy consumption. Growth in overall scale of data center is estimated to be 9%/11% in 2014E/2015E, the growth in scale of internet data center (IDC) is faster at 13%/11% in 2014E/2015E.

**Energy efficient solutions demand is rising**

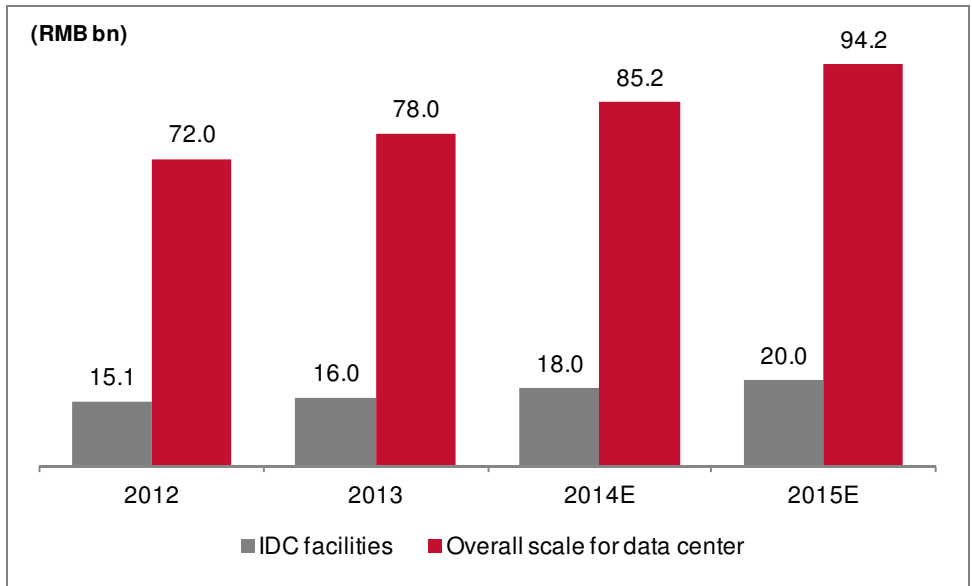
Based on the massive scale of data center and raising energy savings need, we estimate the growth in energy savings demand from data centre will grow continuously. Boer Power (1685 HK) captured the trend since 2013, revenue from energy efficient solutions of data centers jumped 84% yoy to RMB157mn in 2013, we believe due to the strong customer base like China Unicom, China Mobile, Centrin Data Systems which is a leading cloud computing operations service provider, BP will be riding on a growing need to save energy.

**Exhibit 8: Energy consumption components in data center**



Source: OP Research

**Exhibit 9: Stable growth in data center scale**



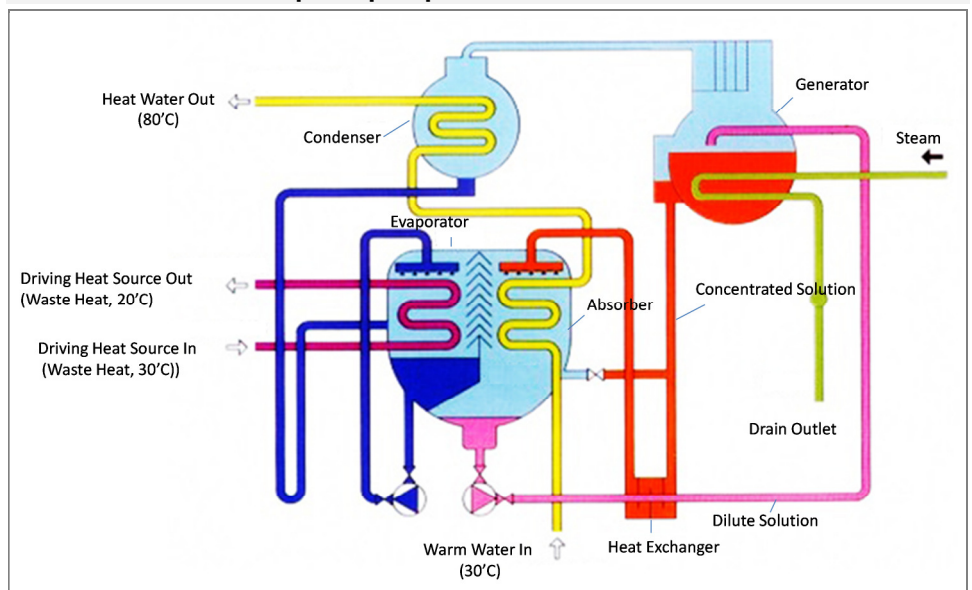
Source: IDC, OP Research

**Recovery of waste-heat is a new energy source**

Recycling of waste-heat is another crucial technology in energy savings. It involves technique of collecting waste heat generated by industrial processes and power plants, using it as driving source to heat or cool down. An example is heat absorption pump, which can be used in heat supply.

It is expected that the potential market for heat absorption pumps in thermoelectric plants is 93kMW, estimated size at RMB32.55bn. Current market is less than 10%, leading equipment suppliers are Shuangliang (600481 SH), Tongfang Kawasaki, Dalian Sanyo. We believe the application of the heat absorption pump is a new energy source with high growth potential to be uncovered. The new subsidiary of Technovator (1206 HK) is a market leader in waste-heat recovery, we believe it is able to ride on this growth.

**Exhibit 10: Heat absorption pump**



Source: OP Research

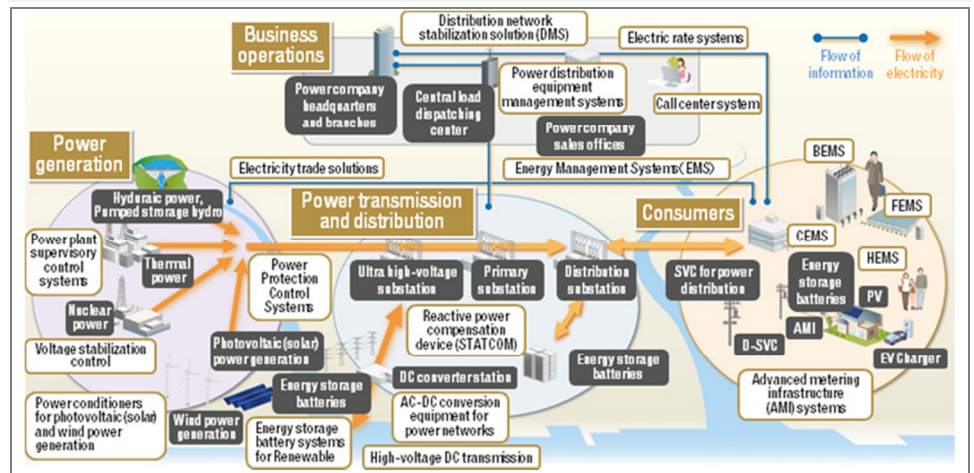
# Smart metering is a foundation for power distribution and energy savings

## Communications is the key in power grid renovation

**From unidirectional to interactive response**

Imagine an electrical device talking to a power generation turbine, and then the turbine reacting promptly to adjust the amount of power supply, creating an interactive relationship between power user and power generator. Smart grid is the application of digital processing and communications to the power grid. The current power network is centralized and unidirectional from power plants to end-users. The new approach allows two-way communications, using a widely distributed intelligence grid, thus achieving reliable, flexible, efficient and secure power delivery and use, facilitating the popularization of unstable renewable energy.

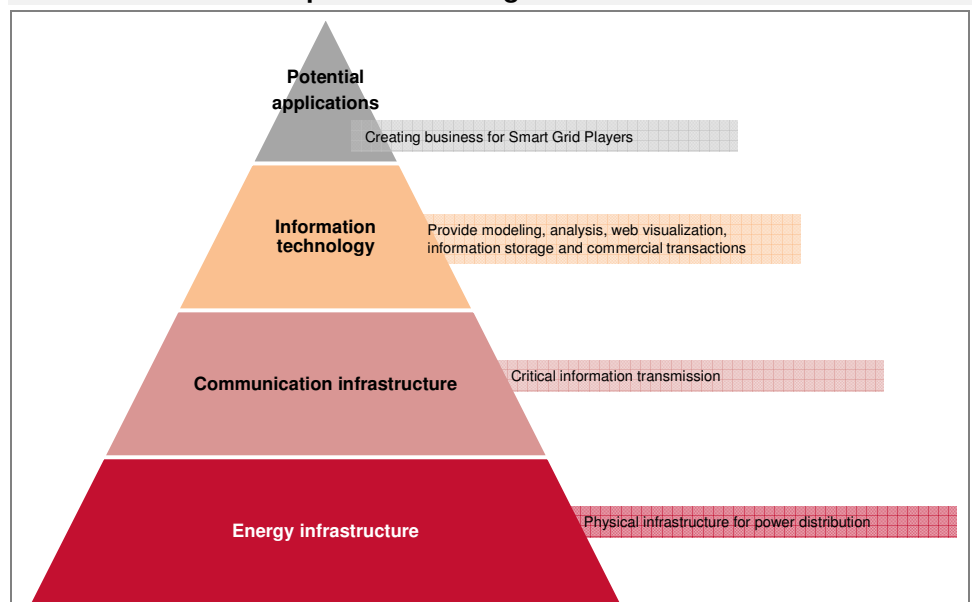
**Exhibit 11: From unidirectional to two-way communications**



Source: Smart Grid 2030, OP Research

The multi-layer framework of smart grid is from energy infrastructure, communication infrastructure, and information technology to potential applications.

**Exhibit 12: Different aspects on smart grid**



Source: OP Research

### Smart meter is neuron of smart grid

Communications and automated response are the core feature of smart grid. The first starting point is constructing Advanced Metering Infrastructure (AMI), which contains smart home components, smart meters, concentrators, network system, metering data management and advanced integrated system, where relevant commercials can be divided into 1) Smart meter manufacturers & 2) AMI technology service providers.

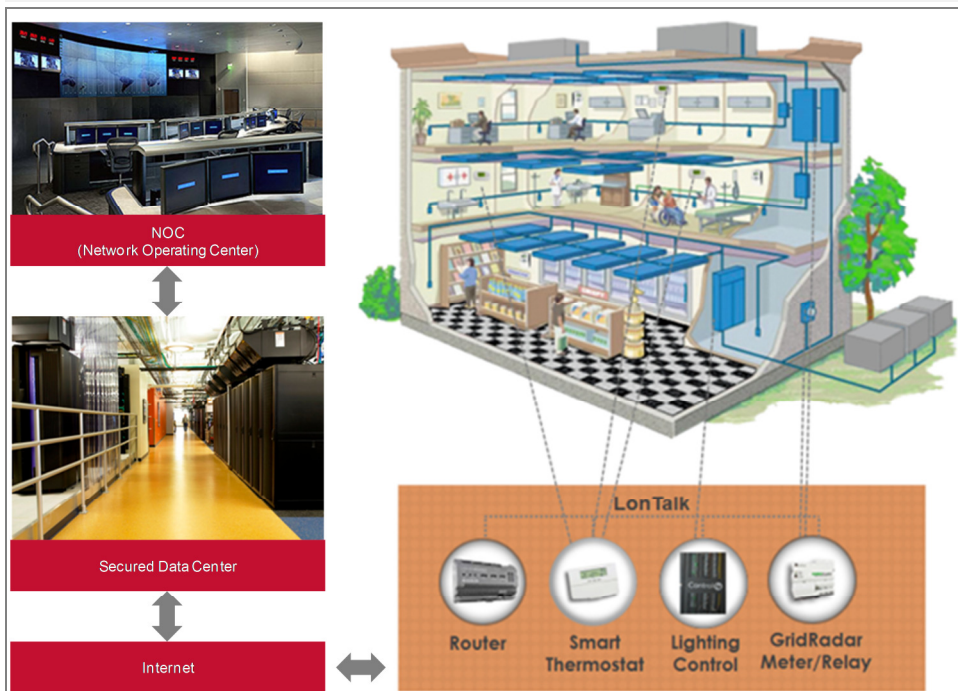
**Exhibit 13: AMI**



Source: Wasion (3393 HK), OP Research

In the global market, smart meters manufacturing is leading by Itron (ITRI US), Landis+Gyr and Elster; while AMI technology is leading by eMeter, Silver Spring and Itron. Luckily, because of the domestic format in China, local firms are able to in on the action. The simplified system of demand management is illustrated below.

**Exhibit 14: Power Demand Management**



Source: Grid Navigator, OP Research

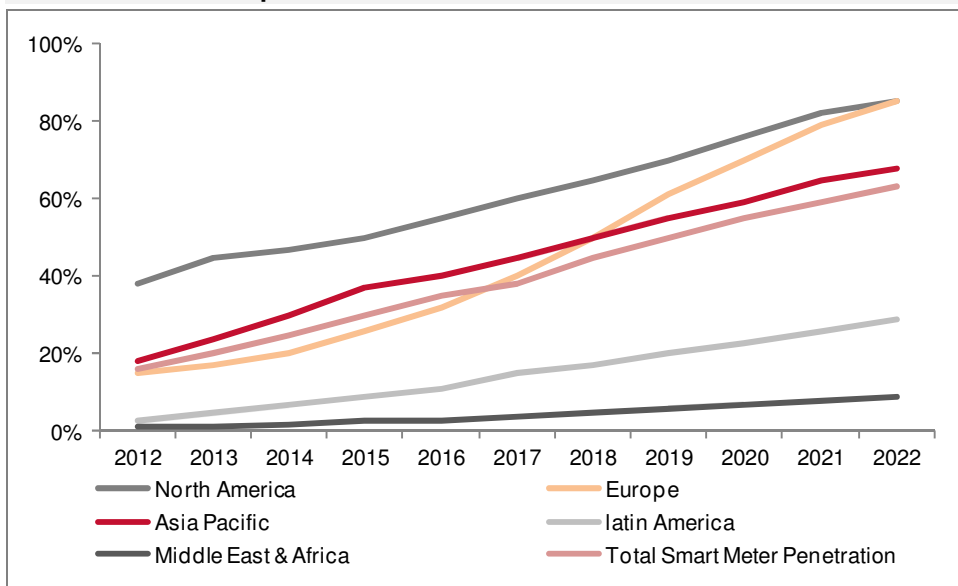
There are two major categories of smart meters, Low voltage 1 Phase for residential and high voltage 3 Phase for commercial. According to IDC, global shipment of smart meters will reach 163mn units in 2015E, CAGR 15.4% from 2012, In-Stat research estimate the industry revenue will exceed USD12bn in 2016E.

### Low penetration of smart meters in developing countries

The global penetration of smart meters is only about 25%, with Middle East and Africa at the lowest of about 1~2%, while North America and Asia Pacific have the highest penetration. We believe Middle East and Africa have the highest potential markets for current smart meter manufactures in North America and Asia Pacific.

The JV of Siemens and Wasion (3393 HK) focuses on developing countries such as South Africa and Indonesia which, we believe, is a kick-off for their export line.

**Exhibit 15: Current penetration**



Source: Navigant Research, OP Research

### Centralized tender rebound in China and sustainable support from replacement need

In China, the penetration at about 60% is high relative compared to other countries. Major demand is centralized by SGCC and CSG which, driven by further penetration, aims to achieve full penetration in 2014E. The average life of the smart meter is five to seven years, hence replacement demands will appear in 2014E, and become the major driver from 2015E onwards. Based on population, penetration increment and replacement needs, the total demand for smart meters from SGCC and CSG is estimated to be at 99.1mn units in 2014E, up 14% yoy. The SGCC centralized tender for smart meters was 66mn units last year. This year the estimated need is 80mn units, up 21.2% yoy.

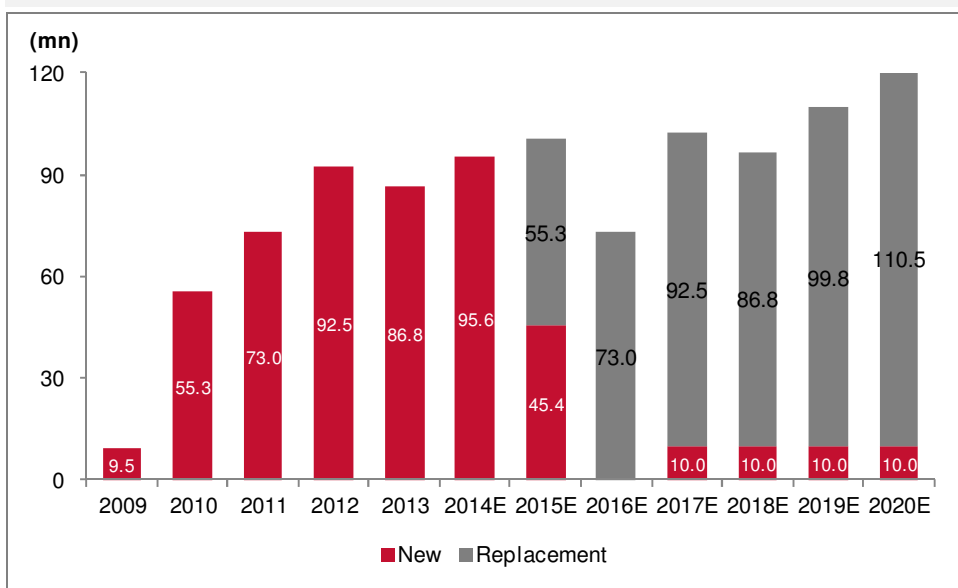
We believe the continuing demand from penetration improvement and replacement needs will support a stable growth of smart meters manufacture. Where the critical elements of a winner depends on R&D ability which, utilizing experience and market leader position to design tailor-made smart meters for commercial use, facilitate power distribution networks and energy savings solution.

Exhibit 16: SGCCV China southern power grid

State Grid Corporation of China (SGCC)	China Southern Power Grid (CSG)
 <p>Headquarter: Beijing</p> <p>Business coverage: 26 provinces in China and overseas markets including the Philippines, Brazil, Portugal, India, and Russia</p> <p>Population coverage: 82%</p> <p>Info: Owns and manages six regional power grid companies, which in turn own and operate inter-provincial high-voltage power transmission grids and local power distribution networks</p>	 <p>Headquarters: Guangzhou</p> <p>Business coverage: 5 provinces in south China and links with Hong Kong and Macau.</p> <p>Population coverage: 18%</p> <p>Info: Owns and manages inter-provincial high-voltage power transmission grids and local power distribution networks in Guangdong, Guangxi, Guizhou, Yunnan, and Hainan provinces.</p>

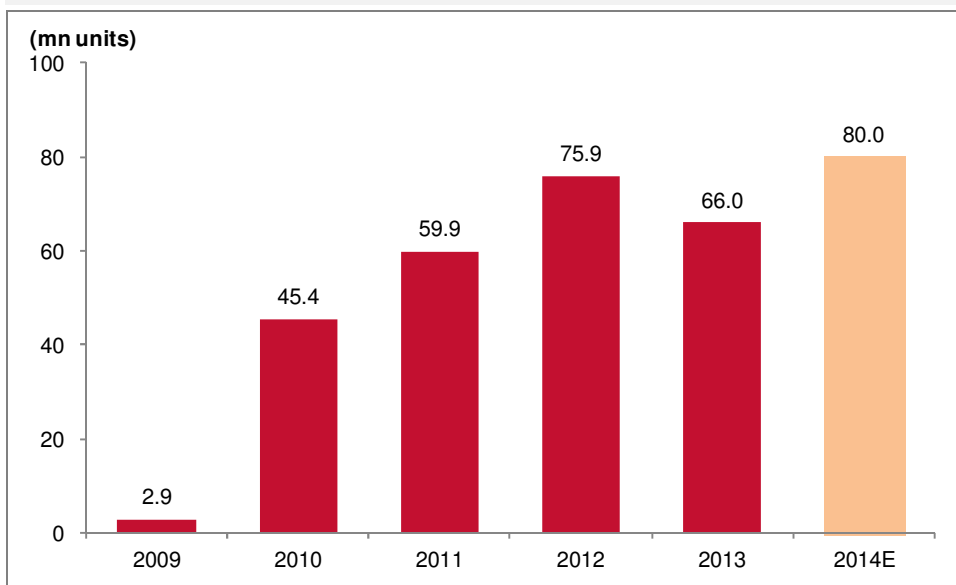
Source: SGCC, CSG, OP Research

Exhibit 17: SGCC and CSG smart meters demand



Source: Tianto Info (Beijing) Consulting, OP Research

**Exhibit 18: SGCC Smart meters centralized tender volume**



Source: SGCC, OP Research

Top winners after two centralized tenders of SGCC in 2014 are Wasion (3393 HK), Linyang (601222 SH), Sanxing (601567 SH), Wasion won RMB603.4mn contracts cumulatively, up 35% yoy, with Linyang winning RMB592.5mn and Sanxing RMB553.8mn.

We believe Wasion (3393 HK) is able to maintain pole position in market, and keep riding on rebound demand for smart meters from state grids.

**Exhibit 19: Top 3 suppliers in SGCC smart meters tender**

Company name	1P meters (‘000 units)	3P meters (‘000 units)	DCT (‘000 units)	Contract ( RMB mn)
Wasion (3393 HK)	1,951.2	269.4	288.4	603.4
Linyang (601222 SH)	1,752.2	277.2	415.4	592.5
Sanxing (601567 SH)	1,885.4	280.0	220.7	553.8

Source: Companies, OP Research

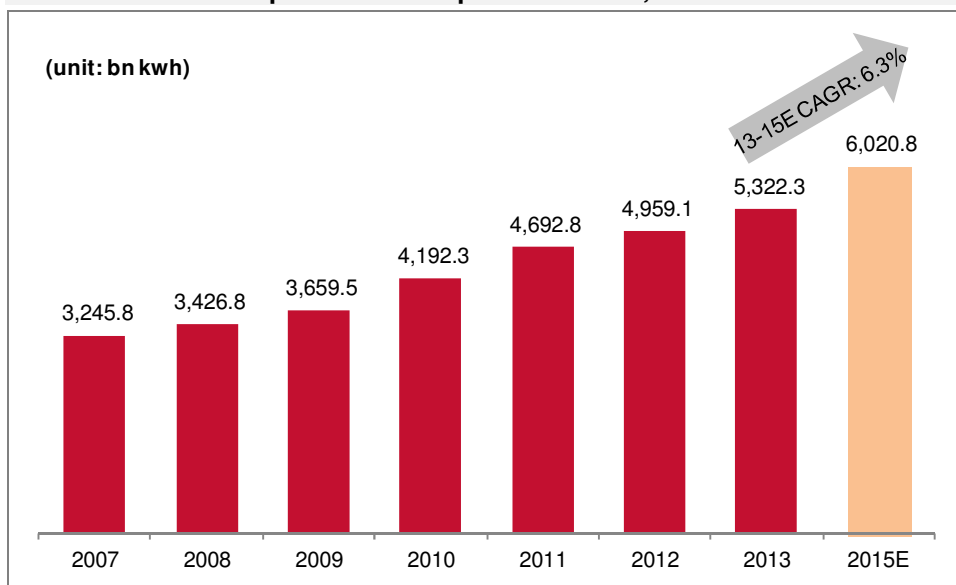
## Obstacle is clear on grid construction

### Ring up the revolution curtain with anti-graft investigation

**Power consumption CAGR 6.3% in 2013-2015**

In 2013, the national society power consumption was 5,322.3bn kilowatt hour (kwh), increased by 7.5% yoy. In which power consumption of primary industry was 101.4bn kwh (up 0.7% yoy), secondary industry was 3,914.3bn kwh (up 7% yoy), tertiary industry was 627.3bn kwh (up 10.3% yoy). According to 12<sup>th</sup> Five Year Plan, the national society power consumption will reach 6,020.8bn kwh, indicating a CAGR of 6.3% in 2013-2015E. This promising growth in power consumption is driving demand for power grid construction.

**Exhibit 20: National power consumption exceed 5,000bn kwh**



Source: NEA, OP Research

**Series of anti-graft investigations in energy sector**

Rather than focus on the quantity growth on power consumption, the revolution of power grids plays a more important role. Curtain was rung up by a series of anti-graft investigation in energy sector, which has brought down high-ranking officials in state energy companies such as Power Construction Corp. of China (PCCC), the State Grid Corp of China (SGCC), China Southern Power Grid (CSG) and also four senior officials at the National Energy Administration (NEA).

**Exhibit 21: Anti-graft investigation in energy sector**

Organization	Position before investigation	Person	Current Situation
NEA	Deputy director	Xu Yongsheng	Removed from NEA and the Communist Party of China
NEA	Head of nuclear power department	Hao Weiping	Under investigation
NEA	Head of renewable energy department	Wang Jun	Under investigation
NEA	Vice director of coal department	Wei Pengyuan	Under investigation
PCCC	Deputy general manager	Huang Baodong	Removed from the Party and Public office
SGCC	General manager assistant	Zhu Changlin	Under investigation
CSG	General manager	Wu Zhouchun	Under investigation

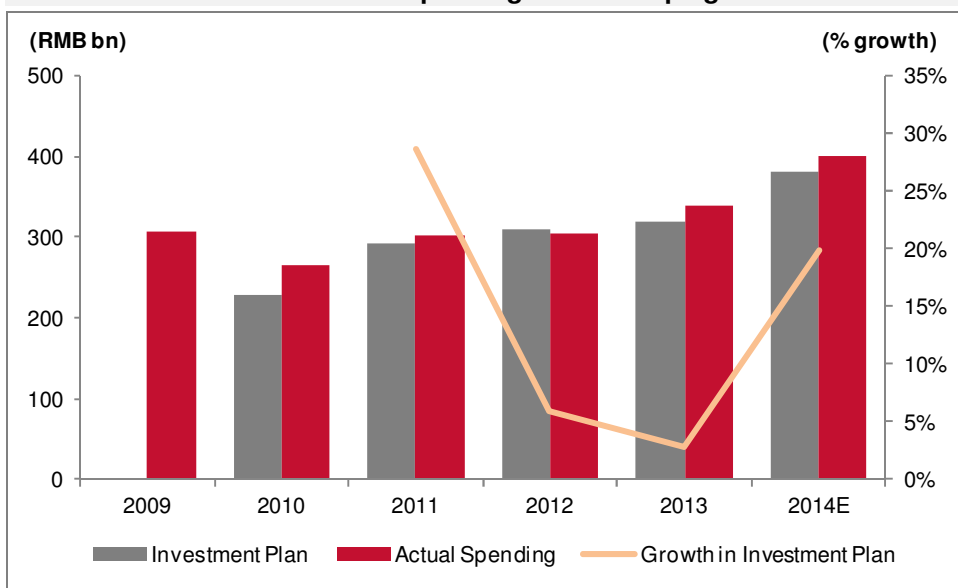
Source: OP Research



### Re-accelerating SGCC investment on grid construction benefitting power cables suppliers

We believe the removal of vested interests is positive to the future development of power grid, in fact, the revolution of power grid regain its velocity. In 2014 Jan, SGCC announced 2014E investment plan, RMB381.5bn for power grid, 13% above 2013 actual spending, up 19% from 2013 target, far beyond 3% increment in 2013, we believe the growth in investment plan is bottoming out. As a necessary material in power grid infrastructure, we believe power cables industry will be one of the beneficiaries to enjoy the V-shape growth of investment.

**Exhibit 22: SGCC investment in power grid – V- shape growth**



Source: SGCC, OP Research

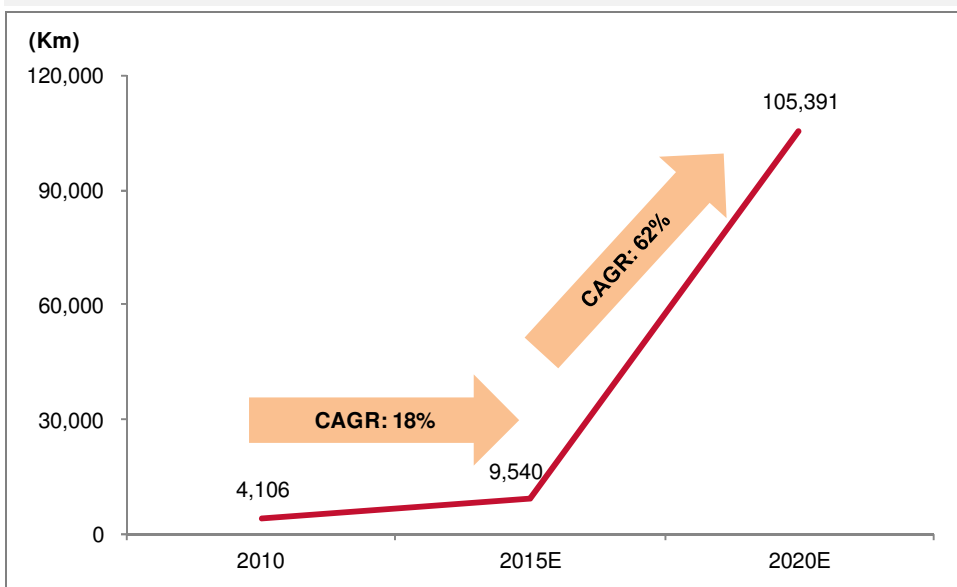
**UHV cables explosive growth in 2015E-2020E drives cables upgrade**

National Energy Administration (NEA) signed a “Assignment for construction of power cables to prevent air pollution” with SGCC and CSG in June, to boost construction of 12 transmission lines, 9 of ultra-high voltage (UHV, 800kV-1,000kV) and 3 of 500kV, for instance, an UHV alternating current (ac) transmission line from inner Mongolia via Beijing, Tianjin to Shandong. SGCC is responsible for the construction of 8 lines (4 ac 4 direct current), completed by 2017 according to NEA. The average length of construction is 2 years, relevant procurement tenders need to be started soon.

The boom in UHV line construction benefits the suppliers of power cables for power distribution and bare wires for overhead power transmission, especially those having an edge on UHV and extra high voltage (EHV, 330kv-800kV) power cables manufacturing. There are only about 20 manufacturers who can produce UHV and EHV power cables, 12 of them are qualified suppliers of SGCC, including Jiangnan Group (1366 HK).

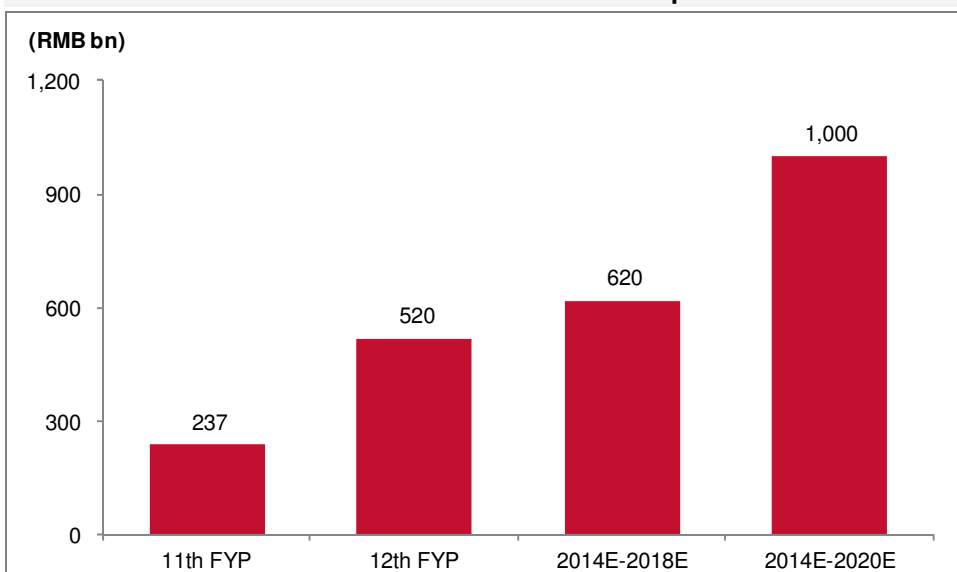
**Few manufactures are able to produce UHV and EHV power cables**

**Exhibit 23: Boom in UHV cables Demand**



Source: SGCC, CSG, OP Research

**Exhibit 24: UHV Investment Plan in China doubled up**



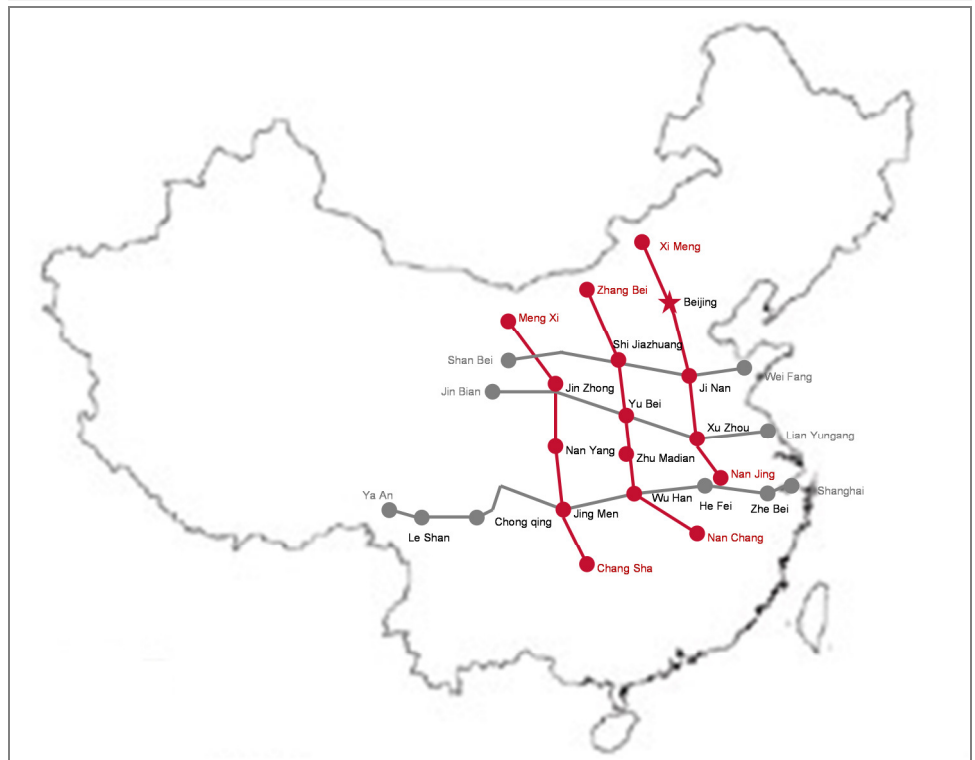
Source: SGCC, CSG, OP Research

**Exhibit 25: 3 Finished UHV lines**

UHV line	AC/DC	In operation	Length (km)	Power input (m kw)	Voltage (kv)	Investment (RMB bn)
Jingdongnan-Nanyang-Jinmen	AC	2008	640	5.0	1000	5.90
Huaiana-Zhebei-Shanghai	AC	2013	656	4.0	1000	18.50
Yunnan-Guangdong	DC	2010	439	5.0	800	13.20
Xiangjiaba-Shanghai	DC	2010	1907	6.4	800	23.30
Jinping-Sunan	DC	2013	2100	7.2	800	22.00
Nuozhadu-Guangdong	DC	2013	1451	5.0	800	18.70
Hami-Zhengzhou	DC	2014	2192	8.0	800	23.40
<b>Total</b>			<b>9384</b>			<b>125.00</b>

Source: SGCC. OP Research

**Exhibit 26: 3 Vertical and 3 Horizontal UHV power transmission lines**



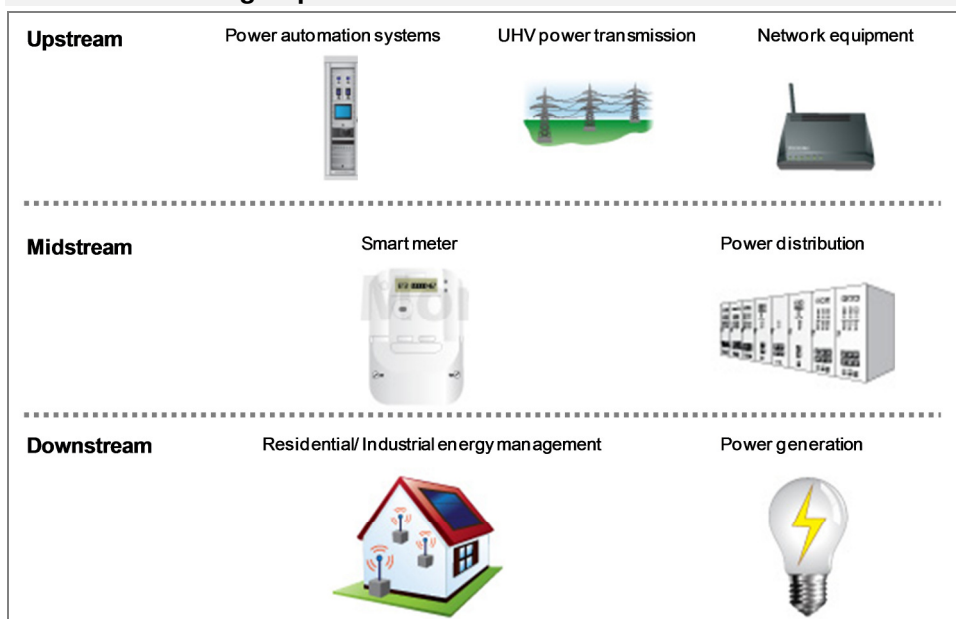
Source: SGCC. OP Research

## Fragmented market encourages consolidation

### Blur border between midstream and upstream facilitates vertical integration

The smart grid production chain is fragmented, vertical integration between midstream and downstream is likely to happen at a mild pace because of their technology similarity, as well as customer base. We expect horizontal consolidation will take place in upstream industry.

**Exhibit 27: Smart grid production chain**



Source: OP Research

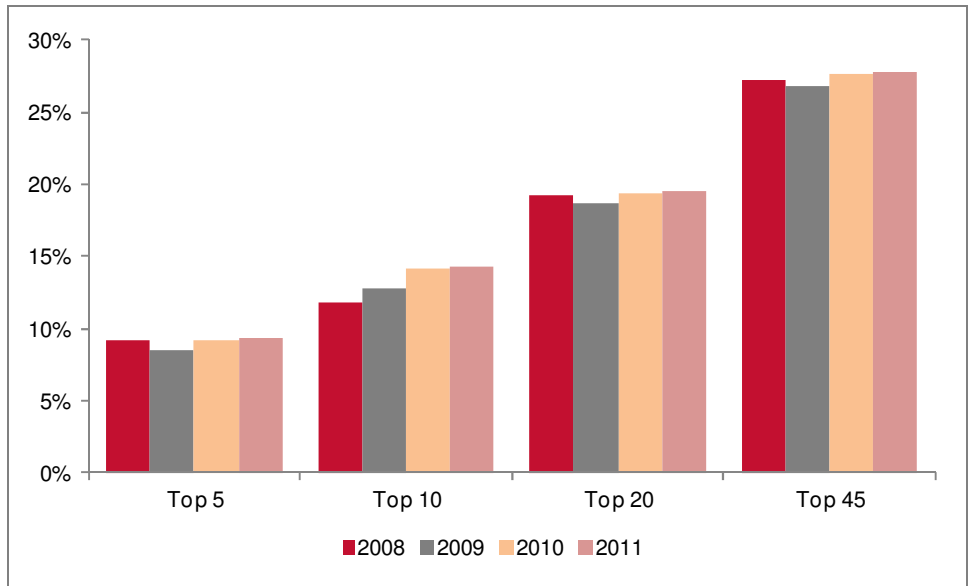
### Top 10 players in cable market account for less than 15% provide room for consolidation

#### Consolidation is happening

Cable market is a four lows industry, 1) Low entry barrier, 2) Low profit, 3) Low end and 4) Low added value. There are more than 4,000 domestic players in 2012, of which more than 90% are small timers. The top 10 players account for 12.7~14.3% of total market share in 2008 to 2011 compared to USA, UK, France, South Korea and Japan, where the top 10 account for more than 60% market share, so we believe there is huge room for consolidation.

However, we believe we are past this irrational phase, corporates with higher technology levels producing extra-high to ultra-high voltage cables, and other special cables could survive the war, standing up with much higher market share and higher profit margins. We expect M&A will become the major profit driver for large scale players, Jiangnan Group (1366 HK) acquired a higher gross margin rubber cables factory (24.8% compared to 15.7% blended GPM in FY12), so we believe they have developed the right strategies and more acquisitions are likely to be forthcoming.

**Exhibit 28: Low Market Concentraion in China Cable Market**



Source: SCI Consulting, OP Research

## Wasion Group (3393 HK) – Climbing up the ladder

### Initial Coverage

**BUY**

Close price: HK\$6.18

Target Price: HK\$8.3 (+34%)

#### Key Data

HKEx code	3393
12 Months High (HK\$)	6.22
12 Month Low (HK\$)	4.10
3M Avg Dail Vol. (mn)	1.47
Issue Share (mn)	951.85
Market Cap (HK\$m)	5,882.44
Fiscal Year	12/2013
Major shareholder (s)	Ji Wei (54%)

Source: Company data, Bloomberg, OP Research  
Closing price are as of 31/7/2014

#### Price Chart



	1mth	3mth	6mth
Absolute %	6.2	15.0	37.2
Rel. MSCI CHINA %	-1.1	1.8	25.3

#### Company Profile

The Group is principally engaged in the development, manufacture and sale of smart meters, data communication terminals, and energy efficient solution.

- Margin expansion for transformation from manufacturer to solution provider.** Wasion Group (3393 HK) is a market leader in smart meters manufacturing, it has established a stable relationship with commercial clients. Upon utilization of readings from smart meters, Wasion is able to design a better power distribution solution, where switchgear is one of the major components for completing the solution. The recent acquisitions of Hunan Switchgear and Wuhan Smart Electrical set a milestone for Wasion, their products are switchgear, circuit breaker, power disruption positioning system, which are used in power distribution solution in industrial buildings, which could help Wasion to penetrate into advanced distribution operations (ADO) market with new revenue flow and further margin expansion potential. It catalyzed transformation of Wasion group, to be a power distribution expertise, we believe the success transformation offer a re-rating opportunities for Wasion to mid-teen PE multiple as an one-stop smart grid solution provider.
- Market recovery supported by remarkable centralized tender result. Replacement demand likely to kick-in 2014 onwards driving 22% earnings CAGR in 2013-2016E.** Smart meters tender from 1st and 2nd tender result of Wasion from State Grid Corporation of China (SGCC), growth by 26% yoy, reach RMB 487mn, with quantity increased by 16%, ASP increased by 8.4%, remains its market leader position. For a higher gross margin product – data collection terminal (DCT), also enjoys a growth of 21.1% yoy. The market expect smart meters demand from SGCC centralized tender will reach 80mn units in 2014E, up 21% from 66mn units in 2013, which is a primary driver for further growth in FY14E.
- Initial BUY.** We initiate our BUY rating on Wasion Group with TP HK\$8.3 based on 13x FY14E PE, which implies 34% upside. We are positive on Wasion's three dimensional expansion plan 1) Acquire new companies and expand by internal R&D, expanding products in ADO, 2) Expand corporate customer base, as a foundation to become power distribution solution provider, 3) Export smart meters to developing countries.

#### Exhibit 29: Forecast and Valuation

Year to Dec (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	2,452.3	2,412.3	2,944.0	3,388.1	3,651.8
Growth (%)	24.6	(1.6)	22.0	15.1	7.8
Net Profit	323.1	401.1	480.1	602.4	727.0
Growth (%)	30.6	24.1	19.7	25.5	20.7
Diluted EPS (HK\$)	0.433	0.534	0.639	0.801	0.967
EPS growth (%)	30.8	23.2	19.7	25.5	20.7
Change to previous EPS (%)					
Consensus EPS (HK\$)			0.604	0.710	0.813
ROE (%)	13.0	14.7	15.9	17.9	19.1
P/E (x)	13.6	11.0	9.2	7.3	6.1
P/B (x)	1.7	1.5	1.4	1.2	1.1
Yield (%)	3.1	3.6	4.4	5.5	6.6
DPS (HK\$)	0.180	0.210	0.255	0.321	0.387

Source: Bloomberg, OP Research

## Valuation re-rate driven by vertical integration

### Acquired Hunan Switchgear to compete in power distribution

Leveraging on its leadership in Advanced Metering Infrastructure (AMI), Wasion utilizes its strong customer base and upgrade to the production chain in Advanced Distribution Operations (ADO) through acquisition of its suppliers. Recent acquisitions are able to provide synergy against current business by consolidating the ADO.

Wasion acquired 65% of the equity interest in Hunan Switchgear Co., Ltd. (湖南開關, HNKG) for RMB50mn. Hunan Switchgear is a supplier of switch equipment, applications including power transmission and distribution, substation equipment. Besides domestic market, it also exports globally to Turkey, Malaysia, Vietnam, Saudi Arabia etc., more than 20 countries in all, mainly used in substation, industrial plants, power plants, and government buildings.

Key products of HNKG are switchgears and circuit breakers. Switchgear is mainly designed to be applied to 3-phase alternative current (ac) power system, to transmit and distribute electricity; control, protect and measure the circuits with embedded circuit breakers. Smart switchgear is especially important in an automatic power distribution system; it could cut off and recover power supply automatically once fault is detected through the application of smart meters, which may take a minute compared to manual operations of 30mins to an hour.

**Automatic feature of switchgear enhance power stability**

#### Exhibit 30: Switchgear



Source: Hunan Switchgear, OP Research

**Exhibit 31: Self-energy high-voltage circuit breaker**



Source: Hunan Switchgear, OP Research

**Exhibit 32: Other series of products**

系列产品 Other Series Products

HNS 湖南开关有限责任公司 HUNAN SWITCHGEAR CO., LTD.

<b>开关柜及箱变</b> Switchgear and Box-type substation	JYH1-40.5 户内高压真空断路器 JYH1-40.5 SF6 indoor vacuum enclosed switchgear	KYH28A-24 户内高压真空断路器 KYH28A-24 indoor vacuum enclosed switchgear	GSD 低压断路器 GSD low-voltage distribution switchgear	GCK 低压抽出式断路器 GCK low-voltage抽出式 switchgear	HGN10-12 户内高压真空断路器 HGN10-12 indoor vacuum enclosed ring network switchgear	HGN20-10 户内高压真空断路器 HGN20-10 indoor vacuum enclosed ring network switchgear	QS-1.1AFJZ 跌落式熔断器 QS-1.1AFJZ跌落式熔断器	XGW-12 户外高压真空断路器 XGW-12 outdoor high-voltage vacuum enclosed switchgear
	LW27-40.5 户外高压真空断路器 LW27-40.5 outdoor high-voltage SF6 vacuum circuit breaker	ZN-27.5 户外高压真空断路器 ZN-27.5 outdoor high-voltage vacuum circuit breaker	ZN6A-12 户外高压真空断路器 ZN6A-12 outdoor high-voltage vacuum circuit breaker	ZN-12V50kV 户外高压真空断路器 ZN-12 V50kV outdoor high-voltage vacuum circuit breaker	ZW6-12 户外高压真空断路器 ZW6-12 outdoor high-voltage vacuum circuit breaker	ZN28A1-12 户外高压真空断路器 ZN28A1-12 outdoor high-voltage vacuum circuit breaker	ZW32-24 户外高压真空断路器 ZW32-24 outdoor high-voltage vacuum circuit breaker	FZW35-40.5 户外高压真空断路器 FZW35-40.5 outdoor high-voltage vacuum isolated load switch
	GW4-252 户外隔离开关 GW4-252 outdoor isolating switch	GW7-252 户外隔离开关 GW7-252 outdoor isolating switch	GW16-252 户外隔离开关 GW16-252 outdoor isolating switch	GW17-252 户外隔离开关 GW17-252 outdoor isolating switch	GW9-72.5 户外隔离开关 GW9-72.5 outdoor isolating switch	GW10-72.5 户外隔离开关 GW10-72.5 outdoor isolating switch	GW5 户外隔离开关 GW5 outdoor isolating switch	GW4 户外隔离开关 GW4 outdoor isolating switch

Source: Hunan Switchgear, OP Research



Its customers include Hunan local government, power plants, hydropower stations, power grids, petroleum, universities and mines. We believe the acquisition helps Wasion to develop a full ADO chain, meanwhile the marketability and brand name of Wasion, which is marker leader of smart meter in China, could help HNKG to expand overseas market, creating a synergy.

**Exhibit 33: Previous Customers**

<p><b>政府工程 &gt;&gt;&gt;</b> Government projects</p> <ul style="list-style-type: none"> <li>湖南省人民政府</li> <li>中共湖南省委办公厅</li> <li>中共湖南省直机关党校</li> <li>中共湖南省委统战部</li> <li>湖南省高级人民法院</li> <li>湖南省司法厅</li> <li>湖南省邮政局</li> </ul>	<p><b>电网、电力 &gt;&gt;&gt;</b> Power grids, power</p> <ul style="list-style-type: none"> <li>国家电网公司</li> <li>南方电网公司</li> <li>中国电力投资集团公司</li> <li>中国华电集团公司</li> <li>中国大唐集团公司</li> <li>中国华能集团公司</li> <li>中国国电集团公司</li> <li>中国东方电气集团公司</li> </ul>	<ul style="list-style-type: none"> <li>中南林业大学</li> <li>湖南大学</li> <li>湖南师范大学</li> <li>湖南省博物馆</li> <li>北京友谊宾馆</li> <li>中国航空动力机械研究所</li> </ul>
<p><b>电厂、电站 &gt;&gt;&gt;</b> Power plant, hydropower station</p> <ul style="list-style-type: none"> <li>华电福州可门电厂2 × 600MW</li> <li>华电长沙电厂2 × 600MW</li> <li>大唐湘潭电厂2 × 600MW</li> <li>贵州大方电厂4 × 300MW</li> <li>贵州鸭溪电厂4 × 300MW</li> <li>贵州黔西电厂4 × 300MW</li> <li>玉环电厂4 × 300MW</li> <li>南海电厂2 × 300MW</li> <li>湖南益阳电厂2 × 300MW</li> <li>耒阳电厂2 × 300MW</li> <li>山东里彦电厂2 × 300MW</li> <li>贵州野马寨电厂3 × 200MW</li> <li>中国长江三峡工程开发总公司向家坝电站</li> <li>西藏沃卡满拉水电站</li> <li>内蒙古锡林格勒盟灰腾梁风电场</li> <li>神东保德研石电厂</li> <li>大唐金竹山电厂</li> <li>国华协合（巴彦淖尔）风电场</li> <li>湖南沅溪水电开发有限公司</li> </ul>	<p><b>石油、化工、造纸 &gt;&gt;&gt;</b> Petroleum, chemical, papermaking</p> <ul style="list-style-type: none"> <li>新疆石油管理局</li> <li>中国石油锦州石油化工有限公司</li> <li>新疆华泰重化工有限责任公司</li> <li>广东东莞顺裕纸业</li> <li>湖南泰格林纸业</li> <li>贵州开磷（集团）有限公司</li> <li>湖南省祁东洪城水泥有限公司</li> <li>天津大沽化工股份有限公司</li> <li>衡阳建滔石化有限公司</li> <li>湖南智成化工有限公司</li> <li>上海龙净环保有限公司</li> <li>中石化珠江三角洲输油管道项目</li> </ul>	<p><b>冶金、钢铁、矿山 &gt;&gt;&gt;</b> Metallurgy, iron and steel, mine</p> <ul style="list-style-type: none"> <li>中国铝业</li> <li>湖南华菱湘潭钢铁有限公司</li> <li>湖北武汉钢铁集团公司</li> <li>河南平顶山煤业集团</li> <li>广西平果铝业集团</li> <li>广西华银铝业</li> <li>神华集团包头矿业有限公司</li> <li>湖南金盛钰业有限公司</li> <li>湖南省煤业集团</li> <li>河南开滦集团煤业公司</li> <li>山西振兴集团有限公司</li> <li>灵宝市新灵铝业有限公司</li> <li>新余钢铁股份有限公司</li> <li>阳春新钢铁有限公司</li> <li>新疆八一钢铁有限公司</li> <li>江南机器集团</li> <li>湖南涟邵矿业集团</li> <li>湖南资兴矿业集团</li> <li>湖南白沙煤电集团</li> <li>陕西秦岭水泥集团铜川公司</li> <li>河南省焦作钢厂</li> <li>贵州瓮安煤矿</li> </ul>
	<p><b>大专院校、宾馆 &gt;&gt;&gt;</b> Institutions, hotels</p> <ul style="list-style-type: none"> <li>国防科技大学</li> <li>中央财经大学</li> <li>中南大学</li> </ul>	

Source: Hunan Switchgear, OP Research

**R&D enhancement through acquisition of Wuhan Smart Electrical**

Before that, Wasion acquired 66% of the equity interest in Wuhan Smart Electrical co.,Ltd (武漢百楚科技有限公司, BCSC) for RMB5.29mn in 2014 May. The strategic relationship with Germany Tavrida(德國特瑞德) and support by R&D in Huazhong University of Science and Technology, will enhance the R&D ability of Wasion.

BCSC's products focus on medium –voltage of 12kV power distribution related components, core technologies are power disruption positioning system, and 10kV smart grid self-recovery system. The system enables grid operator identifies the position of power disruption and rerouted so the disturbance will be limited in a small area of neighborhood only.

**Power disruption positioning system**

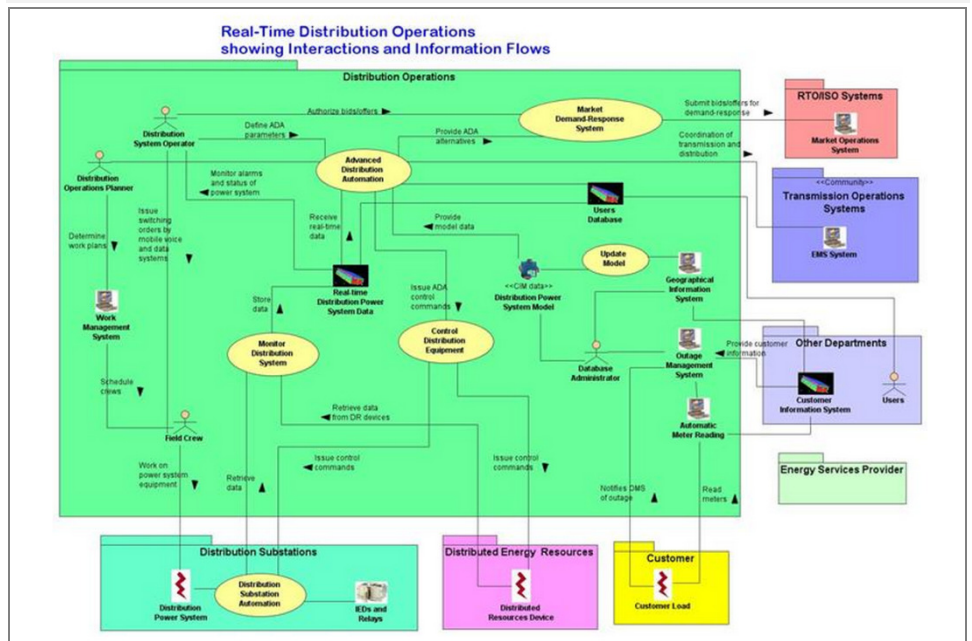
**Becoming power distribution solution provider**

We believe the acquisition of the above two companies are critical moves for Wasion, because their major products, switchgears, circuit breakers, and disruption detection system, would consolidate the ADO chain, assist Wasion to transform from a single product manufacturer to power distribution solution provider. The vertical integration provides a greater growth potential in turnover, and margin expansion. The electrical distribution solutions segment and energy efficient solution usually enjoy 40%-50% gross margin, where gross margin of manufacturing of electronic meters is around 33%. We believe Wasion is able to speed up their development in power distribution solution and energy efficiency, in fact, energy efficiency has contributed 2% of revenue in FY13, with gross margin of 38%, growth 52% yoy.

**Relief dependence on state grids**

Moreover, it will lower the concern of heavy reliability on state grids. In fact, State Grid Corporation of China (SGCC) and China Southern Power Grid (CSG) contributed 75% of total turnover in FY13, 25% from non-state grid. In which, demand of smart meters and data collection terminals (DCT) is mainly driven by SGCC and CSG, accounted for 80% and corporate accounted for 20% in AMI, SGCC and CSG accounting for 50% and corporate accounted for 50% in ADO. In such, we believe the transformation will reduce the dependence of state grids, which is an important move to long term growth.

**Exhibit 34: Real-time distribution and information interaction**



Source: OP Research

## Centralized tender re-accelerate

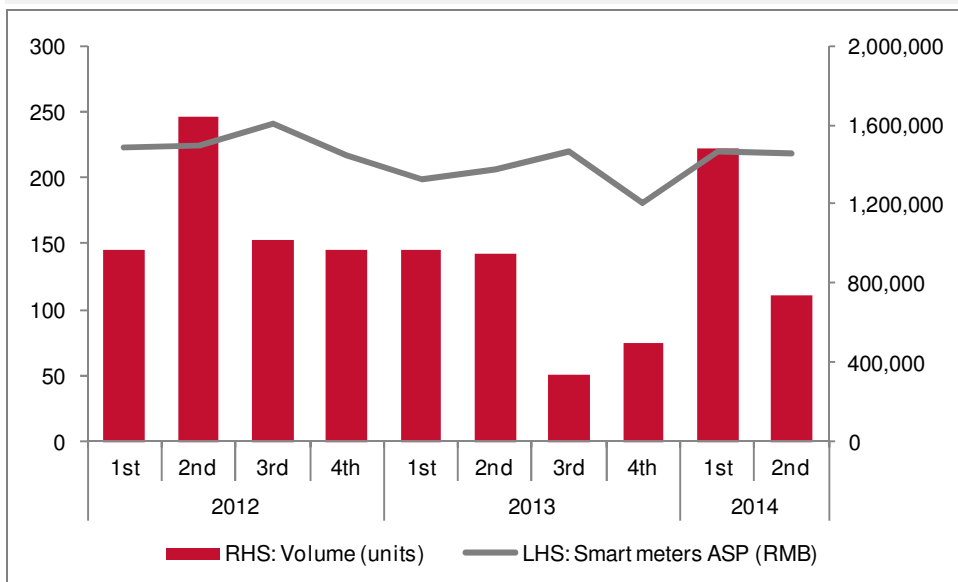
### Remarkable tender result with improving ASP and volume

The major income source of Wasion is smart meters, as mentioned before, is highly subject to the demand of state grids, which is reflected in centralized tender results that organize 4-5 times each year for State Grid Corporation of China (SGCC) and 2-3 times each year for China Southern Power Grid (CSG), the volume of smart meters from SGCC is expected to reach 80mn units in 2014E, up 21% yoy.

#### Increase in both Volume and ASP

From the first and second tender results, we see that the volume and ASP for smart meters recovered after a dip in 2013, the sales volume and ASP up 15.8% and 8.4% yoy respectively, related turnover up 25.5% yoy as a result. We believe the jump is due to increasing mixture of 3P meters (commercial use) which ASP is around RMB400 to 500, compared to RMB100 to 200 for 1P meters (residential use).

**Exhibit 35: Smart meters tender result for Wasion**



Source: Company, OP Research

The penetration of smart meters is about 60% after 6 years of implementation, we believe the new demand will still be the driver in 2014E, at 95.6mn units. However, the new demand is likely to be fulfilled in 2015E at 45.4mn units, by then, we expect replacement demand will arise because of the lifetime of smart meters is 5 to 7 years, total demand in 2015E will be 100.7mn units. Overall demand will reach a bottom in 2016E for 73mn units, rebound to 102.5mn units in 2017E, and stay high at 96.8mn/109.8mn/120.5mn in 2018E/2019E/2020E. We believe the continuous demand could provide a stable organic growth in smart meters segment, where Wasion should be able to perform better than the industry average due to diversification of customer base from corporate needs.

### Rank Top in 2014 maintaining market leader position

Together with the increase in data collection terminals (DCT), the amount sum of tender for 1<sup>st</sup> & 2<sup>nd</sup> tender up 35% yoy, reached RMB603mn, rank Top, maintaining its market leader position. The total backlog as at 2014 June is about RMB 1.7bn, which is expected to be completed within 6-9 months as usual, we believe it is an indication of strong growth in 2H14E.

**Exhibit 36: 2014 cumulative tender ranking after 2<sup>nd</sup> tender**

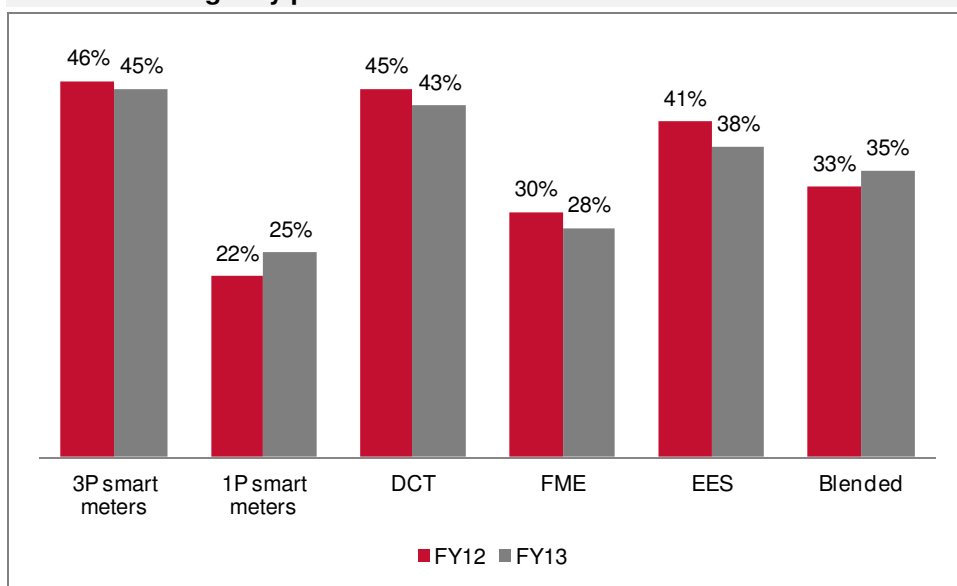
	Volume (k units)			Contract Size (RMB mn)
	1P meters	3P meters	DCT	
Wasion (3393 HK)	1,951.2	269.4	288.4	603.4
Linyang (601222 SH)	1,752.2	277.2	415.4	592.5
Sanxing (601567 SH)	1,885.4	280.0	220.7	553.8

Source: Company, OP Research

### Margin improvement driven by power distribution business

The proportion of 3-phase meters in electronic meters rebound, led to margin expansion from 30.2% in FY11 to 32.8% in FY12. With the heavier weight of high margin DCT and Energy Efficient Solution, the blended gross margin increased to 35.1% in FY13, 2.3ppt improvement compare to 32.8% in FY12. We expect development strategy of increasing ADO business through acquisitions and internal focus shift, the gross margin could be further improved, we expect the contribution from ADO will increase from current 1.8% to 3% in FY14E, leading to gross margin expansion to 35.2%/35.5% in FY14/FY15E.

**Exhibit 37: Margin by products**



Source: Company, OP Research

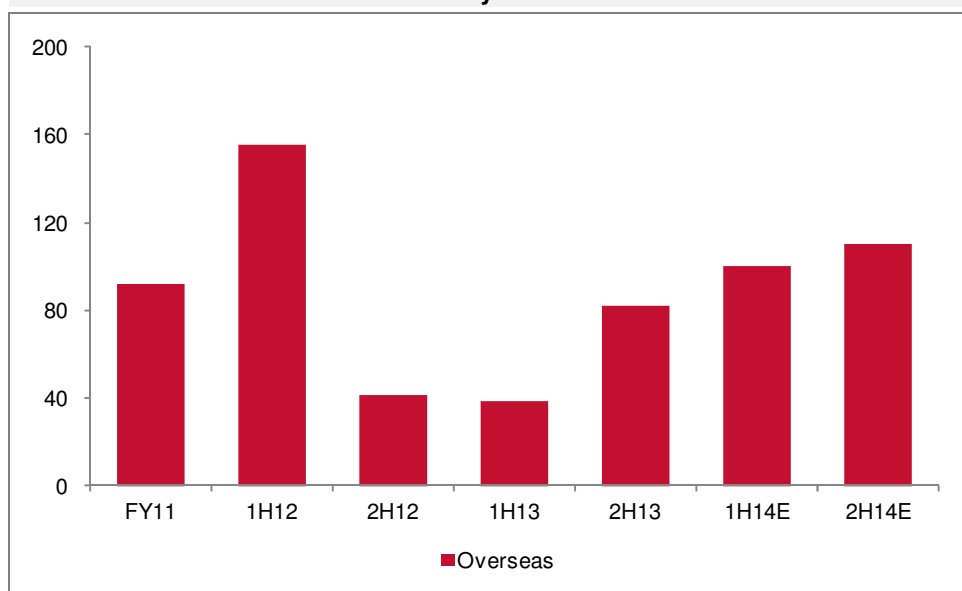
## Overseas market

### Recovery continuing

After disappointing sales in 1H13, overseas sales recovery in 2H13 recorded more than twice hoh. In contrast to the upgrade in domestic market, the overseas market is driven by low-end market in developing countries, such as Croatia, Kyrgyzstan and Mexico, where the JV with Siemens (since April 2013) has penetrated into South Africa and Indonesia markets, and started to take bulk orders.

We expect a continuing recovery overseas because of the risk of political instability in Egypt doesn't exist this year, and the related backlog exceeds RMB100mn, compared to RMB38.8mn turnover from overseas market in 1H13, and RMB121mn in FY13. We estimate income from overseas markets will grow by 66% in FY14E, contribute 7% of total turnover, compared to 4% in FY13.

**Exhibit 38: Overseas market recovery**



Source: Company, OP Research

## Initiate BUY on vertical integration

**Acquiring ADO components suppliers, assist in completing ADO chain kick off valuation re-rate.** The two acquired companies are major manufactures of switchgears and circuit breakers which, together with current major products of smart meters, could complete AMI and ADO chain. We believe power distribution business is a future growth driver of Wasion group, and probably lead to margin expansion.

Besides, technology requirement of smart meters for state grids and corporate are different, where products for state grids are standardized, and that for corporate is tailor-made, the R&D capability becomes more important. We believe the acquisition of Wuhan Smart Electrical will bring enhancement for R&D in power distribution technology.

**Maintains market leader position, enjoys demand rebound from SGCC from 2014E onwards.** The tender result indicates a high growth in revenue. In FY13, SGCC accounted for 65% of total turnover, we believe the remarkable tender result of 35% growth yoy is an indication of strong growth for FY14E turnover. We forecast a topline growth of 22%/15% in FY14/15E, based on the industry demand pattern.

We expect gross margin to remain stable, with upside potential, depending on the future development of ADO business. We believe there is a high probability event according to the development strategy, and the strong net cash position.

**Continuous diversification of customer base is a foundation of future growth, and healthier balance sheet.** The contribution proportion from state grids has been decreasing since FY10, we believe the customer diversification is a foundation for future development of power distribution solutions. This also helps with account receivables improvement, we see a significant improvement of accounts receivable days from 314 days to 260 days since FY10, and thus the cash conversion cycle is improved from 156 days to 56 days, the healthier balance sheet is a sign of good management ability. Besides, we are paying attention to the fluid measurement equipment (FME), such as smart water meters, which is expected to enter rapid growth in 2014E-2020E due to penetration improvement.

**Initiate BUY with TP HK\$8.3, based on valuation upgrade.** We initiate our BUY rating on Wasion Group with TP HK\$8.3 based on 13x FY14E PE, which implies 34% upside.

## Key Risks

### **Scale down of SGCC centralized tender in 2H14E**

The smart meters demand is mainly driven by SGCC centralized tenders, we believe there will be two or three more tenders in 2H14E. Any delay in tenders or scale down will lead to depress in sales volume.

### **Margin erosion arising from intensive competition in smart meters**

As a market leader in smart meters, the market share of Wasion Group is around 3%~4%, it is a highly competitive market. Although we believe the quality provide competitive advantage against others, the competition may bring down ASP in later tenders.

### **Development in power distribution business slower than expected**

Although Wasion Group has actively acquired power distribution equipment providers in 1H14E, the synergy from acquisition may work out later than expected, and it depends on the ability of Wasion Group to market themselves as power distribution solution provider instead of equipment providers.

## Appendix I – Key Management Profiles

**Mr. Ji Wei (吉為), Founder/ Chairman:** Aged 58, Mr. Ji is responsible for the Group's overall strategic planning and the formulation of corporate policies and has over 28 years of experience in management. Prior to founding the Group in 2000, Mr. Ji was a business manager of Hunan Province Minerals Import and Export Company (湖南省五金礦產進出口公司) between 1980 and 1985 and the import and export manager of Hunan International Economic Development (Group) Company (湖南省國際經濟開發(集團)公司) between 1985 and 1989. Mr. Ji is also a director of each of Hunan Willfar Information Technology Co., Ltd. (湖南威遠信息技術有限公司) ("Hunan Willfar"), Hunan Classic Investment Co., Ltd. (湖南經典投資有限公司) ("Hunan Classic"). Mr. Ji was appointed as a member of the Chinese People's Political Consultative Conference of Hunan Province from 2007 to 2012 and he was re-elected in 2013.

**Ms. Cao Zhao Hui (曹朝輝), CEO:** Aged 46, Ms. Cao graduated from Hunan Commerce College in financial accounting and graduated from the Hunan Financial and Economic College with a degree in Economics. She also obtained a degree in executive master of business administration (EMBA) from the University of Hunan (湖南大學). Ms. Cao is also a director of each of Hunan Willfar, Changsha Weihua Property Development Co., Ltd. (長沙威華置業有限公司) ("Weihua Property"), Changsha Weizhong Chemical Machinery Co., Ltd. (長沙威重化工機械有限公司) ("Weizhong Machinery") and Hunan Classic.

**Mr. Zeng Xin (曾辛), General Manager of Changsha Weisheng Energy Industrial Technology Co., Ltd:** Aged 44, Mr. Zeng graduated from the National University of Defense Technology with a degree in system engineering in 1992. During 1992 to 1993, he studied in the Qinghua University for a postgraduate degree. In 1995, Mr. Zeng obtained a master degree in engineering from the China Academy of Space Technology (中國空間技術研究院) and participated in several research projects in the China Academy of Space Technology (中國空間技術研究院). Mr. Zeng worked with Hunan Weisheng as a system engineer, director of research and director of system between 1995 and 1999 and as the general manager with Hunan Willfar between 1999 and July 2004.

**Mr. Choi Wai Lung Edward (蔡偉龍), CFO/Company Secretary:** Aged 45, Mr. Choi is a fellow member of the Hong Kong Institute of Certified Public Accountants and the Association of Chartered Certified Accountants with over 23 years of experience in accounting, auditing and finance.



## Appendix II – Shareholding Structure

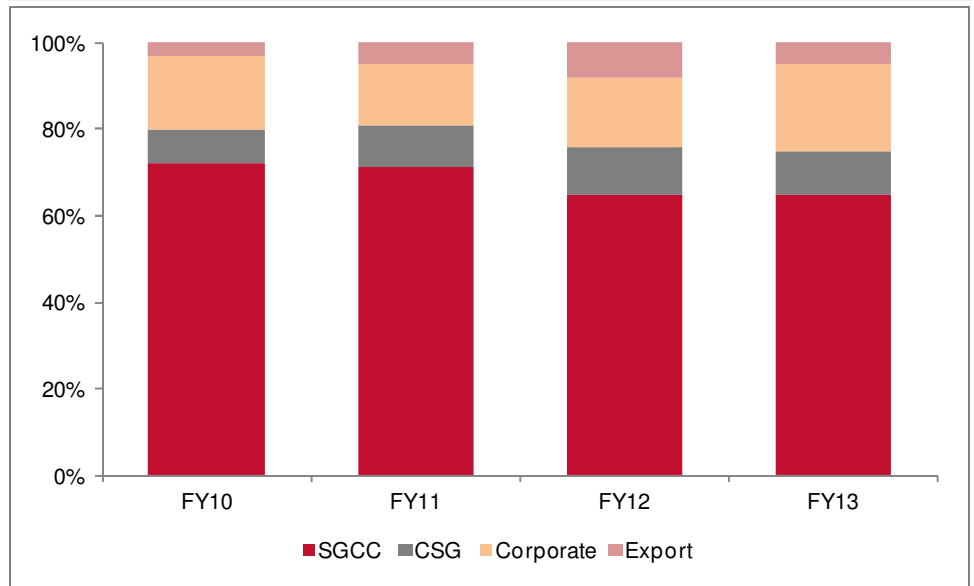
### Exhibit 39: Shareholding structure

Name of shareholder	% of share holding
Ji Wei (Chairman)	54%

Source: OP Research

### Appendix III – Customer Base

Exhibit 40: Increasing contribution from corporate



Source: Company, OP Research

## Financial Summary – Wasion Group (3393 HK)

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Income Statement (RMB mn)</b>					
Electronic meters	2,015	1,851	2,267	2,524	2,601
Data collection terminals	409	518	599	723	797
Energy efficiency solution	28	43	79	141	254
<b>Turnover</b>	<b>2,452</b>	<b>2,412</b>	<b>2,944</b>	<b>3,388</b>	<b>3,652</b>
YoY%	25	(2)	22	15	8
COGS	(1,648)	(1,566)	(1,907)	(2,185)	(2,313)
<b>Gross profit</b>	<b>805</b>	<b>847</b>	<b>1,037</b>	<b>1,203</b>	<b>1,339</b>
Gross margin	32.8%	35.1%	35.2%	35.5%	36.7%
Other income	31	75	31	31	31
Selling & distribution	(207)	(207)	(242)	(268)	(285)
Admin	(148)	(149)	(154)	(147)	(140)
R&D	(118)	(134)	(164)	(188)	(203)
Other opex	0	0	0	0	0
<b>Total opex</b>	<b>(473)</b>	<b>(490)</b>	<b>(559)</b>	<b>(603)</b>	<b>(628)</b>
<b>Operating profit (EBIT)</b>	<b>362</b>	<b>432</b>	<b>509</b>	<b>631</b>	<b>743</b>
Operating margin	14.8%	17.9%	17.3%	18.6%	20.3%
Provisions	0	0	0	0	0
Interest Income	48	48	50	62	86
Finance costs	(54)	(33)	(33)	(33)	(33)
Profit after financing costs	355	447	526	659	796
Associated companies & JVs	0	(7)	0	0	0
Pre-tax profit	355	440	526	659	796
Tax	(32)	(39)	(46)	(57)	(69)
Minority interests	0	0	0	0	0
<b>Net profit</b>	<b>323</b>	<b>401</b>	<b>480</b>	<b>602</b>	<b>727</b>
YoY%	31	24	20	25	21
Net margin	13.2%	16.6%	16.3%	17.8%	19.9%
<b>EBITDA</b>	<b>463</b>	<b>532</b>	<b>596</b>	<b>707</b>	<b>808</b>
EBITDA margin	18.9%	22.0%	20.2%	20.9%	22.1%
<b>EPS (RMB)</b>	<b>0.346</b>	<b>0.427</b>	<b>0.511</b>	<b>0.641</b>	<b>0.774</b>
YoY%	31	23	20	25	21
DPS (HK\$)	0.180	0.210	0.255	0.321	0.387
<b>Cash Flow (RMB mn)</b>					
EBITDA	463	532	596	707	808
Chg in working cap	157	(187)	(188)	(161)	(117)
Others	(2)	(42)	0	0	0
<b>Operating cash</b>	<b>618</b>	<b>303</b>	<b>408</b>	<b>546</b>	<b>691</b>
Interests paid	0	0	50	62	86
Tax	(22)	(35)	(46)	(46)	(57)
<b>Net cash from operations</b>	<b>597</b>	<b>268</b>	<b>412</b>	<b>562</b>	<b>721</b>
Capex	(180)	(30)	(35)	(41)	(44)
Investments	(376)	(264)	(100)	0	0
Dividends received	2	5	0	0	0
Sales of assets	108	32	0	0	0
Interests received	48	28	0	0	0
Others	0	41	0	0	0
<b>Investing cash</b>	<b>(397)</b>	<b>(188)</b>	<b>(136)</b>	<b>(41)</b>	<b>(44)</b>
<b>FCF</b>	<b>199</b>	<b>80</b>	<b>277</b>	<b>522</b>	<b>677</b>
Issue of shares	0	5	0	0	0
Buy-back	0	0	0	0	0
Minority interests	0	0	0	0	0
Dividends paid	(113)	(133)	(197)	(192)	(241)
Net change in bank loans	(483)	29	0	0	0
Others	(63)	(33)	(33)	(33)	(33)
<b>Financing cash</b>	<b>(658)</b>	<b>(132)</b>	<b>(231)</b>	<b>(225)</b>	<b>(274)</b>
<b>Net change in cash</b>	<b>(459)</b>	<b>(53)</b>	<b>46</b>	<b>297</b>	<b>403</b>
Exchange rate or other Adj	0	(1)	0	0	0
Opening cash	1,201	742	688	734	1,031
<b>Closing cash</b>	<b>742</b>	<b>688</b>	<b>734</b>	<b>1,031</b>	<b>1,433</b>
<b>CFPS (HK\$)</b>	<b>0.799</b>	<b>0.356</b>	<b>0.549</b>	<b>0.748</b>	<b>0.959</b>

Source: Company, OP Research

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Ratios</b>					
Gross margin (%)	32.8	35.1	35.2	35.5	36.7
Operating margin (%)	14.8	17.9	17.3	18.6	20.3
Net margin (%)	13.2	16.6	16.3	17.8	19.9
Selling & dist'n exp/Sales (%)	8.5	8.6	8.2	7.9	7.8
Admin exp/Sales (%)	6.1	6.2	5.2	4.3	3.8
Payout ratio (%)	41.6	39.4	40.0	40.0	40.0
Effective tax (%)	9.1	8.7	8.7	8.7	8.7
Total debt/equity (%)	23.3	21.8	19.9	17.6	15.5
Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.8	1.9	1.9	2.0	2.2
Quick ratio (x)	1.6	1.7	1.7	1.8	2.0
Inventory T/O (days)	72	72	72	72	72
AR T/O (days)	210	260	260	260	260
AP T/O (days)	224	276	276	276	276
Cash conversion cycle (days)	57	56	56	56	56
Asset turnover (x)	0.6	0.5	0.6	0.6	0.6
Financial leverage (x)	1.7	1.6	1.7	1.7	1.6
EBIT margin (%)	14.8	17.9	17.3	18.6	20.3
Interest burden (x)	1.0	1.0	1.0	1.0	1.1
Tax burden (x)	0.9	0.9	0.9	0.9	0.9
<b>Return on equity (%)</b>	<b>13.0</b>	<b>14.7</b>	<b>15.9</b>	<b>17.9</b>	<b>19.1</b>
<b>ROIC (%)</b>	<b>13.7</b>	<b>14.8</b>	<b>15.7</b>	<b>18.4</b>	<b>20.9</b>
<b>Balance Sheet (RMB mn)</b>					
Fixed assets	1,026	990	985	986	989
Intangible assets & goodwill	301	413	366	330	306
Associated companies & JVs	0	7	107	107	107
Long-term investments	36	156	156	156	156
Other non-current assets	100	53	53	53	53
<b>Non-current assets</b>	<b>1,463</b>	<b>1,620</b>	<b>1,668</b>	<b>1,633</b>	<b>1,611</b>
Inventories	323	307	374	429	454
AR	1,408	1,718	2,097	2,413	2,601
Prepayments & deposits	0	0	0	0	0
Other current assets	330	408	408	408	408
Cash	742	688	734	1,031	1,433
<b>Current assets</b>	<b>2,803</b>	<b>3,122</b>	<b>3,614</b>	<b>4,281</b>	<b>4,896</b>
AP	1,010	1,182	1,440	1,650	1,746
Tax	41	46	46	57	69
Accruals & other payables	0	0	0	0	0
Bank loans & leases	548	453	453	453	453
CB & othe debts	0	0	0	0	0
Other current liabilities	0	0	0	0	0
<b>Current liabilities</b>	<b>1,599</b>	<b>1,681</b>	<b>1,939</b>	<b>2,160</b>	<b>2,268</b>
Bank loans & leases	57	173	173	173	173
CB & othe debts	0	0	0	0	0
Deferred tax & others	12	14	14	14	14
MI	0	0	0	0	0
<b>Non-current liabilities</b>	<b>70</b>	<b>188</b>	<b>188</b>	<b>188</b>	<b>188</b>
<b>Total net assets</b>	<b>2,596</b>	<b>2,873</b>	<b>3,156</b>	<b>3,566</b>	<b>4,052</b>
<b>Shareholder's equity</b>	<b>2,596</b>	<b>2,873</b>	<b>3,156</b>	<b>3,566</b>	<b>4,052</b>
Share capital	9	9	9	9	9
Reserves	2,587	2,863	3,146	3,556	4,043
<b>BVPS (HK\$)</b>	<b>3.48</b>	<b>3.82</b>	<b>4.20</b>	<b>4.74</b>	<b>5.39</b>
Total debts	606	627	627	627	627
Net cash/(debts)	136	62	108	404	807

**Exhibit 41: Peer Group Comparison**

Company	Ticker	Price	3-mth avg			EPS					Div yld Div yld				EV/		EV/		Net		Gross margin		Net	
			Mkt cap	t/o	PER Hist	PER	EPS	FY1	FY2	3-Yr EPS	Hist	FY1	P/B	P/B	Ebitda	Ebitda	gearing	margin	Hist	ROE	ROE	Sh px	Sh px	
			(US\$m)	(US\$m)	(x)	PER	EPS	FY1	FY2	Cagr (%)	PEG (x)	(%)	(%)	Hist (x)	FY1 (x)	FY1 (x)	Cur Yr	Hist (%)	Hist (%)	(%)	Hist (%)	FY1 (%)	1-mth %	3-mth %
<b>Wasion Group Hol</b>	<b>3393 HK</b>	<b>6.18</b>	<b>754</b>	<b>1.1</b>	<b>11.6</b>	<b>9.7</b>	<b>7.7</b>	<b>19.7</b>	<b>25.5</b>	<b>21.9</b>	<b>0.44</b>	<b>3.4</b>	<b>4.1</b>	<b>1.62</b>	<b>1.47</b>	<b>10.8</b>	<b>9.6</b>	<b>Net cash</b>	<b>35.1</b>	<b>16.6</b>	<b>14.7</b>	<b>15.9</b>	<b>9.7</b>	<b>24.2</b>
HSI		24,756.85			10.9	11.4	10.5	(4.6)	8.5	4.2	2.69	3.7	3.5	1.43	1.37						13.2	12.0	6.0	10.7
HSCEI		11,130.20			8.1	7.7	7.0	5.7	8.8	8.0	0.96	4.0	4.2	1.23	1.13						15.3	14.8	6.2	12.2
CSI300		2,350.25			10.8	9.5	8.2	13.9	15.2	14.6	0.65	2.6	2.8	1.54	1.39						14.3	14.7	9.7	8.1
<b>Adjusted sector avg*</b>					<b>31.9</b>	<b>19.2</b>	<b>14.4</b>	<b>45.4</b>	<b>34.4</b>	<b>31.9</b>	<b>0.65</b>	<b>0.8</b>	<b>1.1</b>	<b>3.49</b>	<b>3.48</b>	<b>24.7</b>	<b>14.7</b>	<b>8.7</b>	<b>31.1</b>	<b>12.0</b>	<b>11.1</b>	<b>15.2</b>	<b>5.7</b>	<b>14.0</b>
Boer Power Holdi	1685 HK	9.45	941	0.5	17.7	13.2	10.3	33.7	28.5	27.6	0.48	3.0	2.7	3.22	2.84	13.3	11.2	0.0	36.0	25.5	18.7	21.7	0.6	5.5
Jiangsu Linyan-A	601222 CH	22.18	1,291	8.3	23.7	18.9	15.1	25.1	24.8	23.8	0.80	0.8	0.8	3.38	2.92	18.3	14.8	0.0	36.6	18.8	15.0	15.8	11.1	34.2
Ningbo Sanxing-A	601567 CH	13.56	890	4.4	20.2	N/A	N/A	N/A	N/A	N/A	N/A	3.5	N/A	2.53	N/A	19.4	N/A	0.0	33.8	12.6	12.9	N/A	22.1	42.8
Zhejiang Chint-A	601877 CH	24.88	4,112	5.9	16.8	14.0	11.7	20.1	19.0	17.2	0.81	3.9	3.9	4.66	4.08	11.8	9.5	0.0	31.2	13.0	30.9	29.8	11.3	14.4
Zhejiang Goldc-A	300349 CH	23.51	694	4.2	37.4	19.4	15.4	92.7	26.1	33.1	0.59	0.3	0.5	5.82	3.87	36.9	23.5	0.0	42.5	23.7	16.9	16.1	0.3	(4.1)
Suntront Techo-A	300259 CH	10.71	478	4.3	29.4	22.3	17.2	31.9	29.4	32.5	0.69	0.6	N/A	4.32	N/A	34.7	N/A	0.0	45.0	32.6	15.7	N/A	0.0	10.0
Shenzhen Hao-A	002356 CH	31.35	411	1.2	120.2	N/A	N/A	N/A	N/A	N/A	N/A	0.8	N/A	2.77	N/A	158.3	N/A	0.0	24.5	3.5	2.3	N/A	5.8	5.0
Shenzhen Clou-A	002121 CH	10..12	665	12.1	57.5	N/A	N/A	N/A	N/A	N/A	N/A	0.2	N/A	3.60	N/A	36.8	N/A	40.6	28.6	6.1	6.6	N/A	24.7	44.3
Henan Senyuan-A	002358 CH	26.70	1,741	9.7	42.8	26.0	17.8	64.3	46.5	47.1	0.55	0.5	0.8	6.36	5.43	32.7	20.2	0.0	37.7	19.8	17.4	21.7	30.0	9.5
Qingdao Tgood-A	300001 CH	20.45	1,344	12.7	67.2	41.5	30.3	62.0	37.0	39.7	1.04	0.4	0.5	N/A	5.34	49.7	36.4	4.0	28.6	8.8	N/A	12.3	32.1	77.1
Integrated Ele-A	002339 CH	8.98	558	4.5	29.7	20.5	15.5	45.2	32.2	23.9	0.86	0.7	N/A	2.81	2.54	29.5	N/A	0.0	34.4	13.0	8.3	10.8	2.2	3.7
Nari Technolog-A	600406 CH	15.40	6,132	51.6	22.1	17.5	13.7	26.2	28.3	27.1	0.65	0.7	1.1	5.67	4.50	22.0	16.5	0.0	26.4	16.9	32.8	24.9	(0.1)	9.4
Xj Electric-A	000400 CH	22.99	3,800	47.0	30.6	17.7	13.3	73.1	33.2	33.7	0.52	0.3	1.3	4.60	3.84	24.1	13.6	0.0	26.2	7.4	14.5	18.7	(1.6)	19.3
Beijing Creat-A	002350 CH	11.06	396	3.4	40.5	23.6	18.0	71.4	31.3	N/A	N/A	0.5	N/A	2.43	N/A	26.2	N/A	0.0	29.0	6.2	6.2	N/A	6.0	13.7
Henan Pinggao	600312 CH	14.70	2,741	30.0	30.1	21.5	14.9	39.8	44.8	39.4	0.55	0.3	0.5	3.16	3.21	27.4	15.9	39.6	25.1	10.5	10.1	16.6	1.0	25.4
Tbea Co Ltd-A	600089 CH	9.19	4,770	51.9	18.8	15.6	12.0	21.0	29.8	24.9	0.62	1.4	1.3	1.60	1.49	15.7	11.5	62.7	15.8	4.6	8.8	10.7	8.3	9.2
Itron Inc	ITRI US	35.98	1,415	11.9	N/A	24.2	16.6	N/A	45.7	(188.9)	N/A	N/A	0.0	1.80	1.72	10.4	10.4	29.1	31.5	(7.5)	(15.5)	7.3	(2.4)	(0.5)
Osaki Electric	6644 JP	578.00	218	1.1	26.5	15.0	10.4	76.5	44.5	45.2	0.33	2.1	2.1	0.65	0.68	10.6	N/A	35.0	25.9	1.2	1.9	5.5	2.1	(4.6)

\* Outliners and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

## Company Update

**BUY**

UNCHANGED

Close price: **HK\$3.60**

Target Price: **HK\$4.3(+20%)**

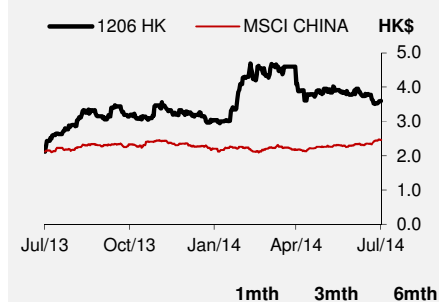
Prior TP: **HK\$5.25**

### Key Data

HKEx code	1206
12 Months High (HK\$)	4.80
12 Month Low (HK\$)	2.09
3M Avg Dail Vol. (mn)	1.02
Issue Share (mn)	521.52
Market Cap (HK\$mn)	1,877.47
Fiscal Year	12/2013
Major shareholder (s)	Tsinghua Tongfang (50.2%)

Source: Company data, Bloomberg, OP Research  
Closing price are as of 31/7/2014

### Price Chart



### Company Profile

Technovator is a market leader in building energy savings solution in China, include building automation systems, energy management systems.

## Technovator (1206 HK) –Building up energy savings enterprise

**Be greedy when others are fearful.** The recently announced financial state of TargetCo is not sexy at this current stage, but we believe the net loss is a necessary process to proceed to strong net profit growth from FY15/16E onwards. Based on the amount of Energy Management Contract (EMC) projects on hands, we expect the TargetCo or Tongfang Energy Saving Engineering Technology (TFES) to break even in FY14E. With consideration of long lifetime of EMC projects (6 to 12 years) and predictable revenue sharing, TargetCo will be able to kick off earnings enhancement for TNI from FY15E onwards. Given that the startup investment cycle will enter its maturity stage and operating leverage, we estimate RMB36mn net profit contribution from TargetCo in FY15E.

**Value accretive for existing shareholder from M&A.** Major business of TFES involves waste heat recovery and its customers include thermal power plants, mining production plant. The core technology is utilizing low temperature and pressure steam as driver to generate higher pressure steam used for heat-supply source. It is an efficient way to fully utilize secondary energy source, in-line with government policy. We believe PB is not a fair valuation tool due to the character of cost structure of EMC projects, and it fails to count in the high profitability of energy savings facilities, which IRR is above 20%.

**Potential spin-off overseas arm and further asset injection a mid-term catalyst. Maintain BUY.** We maintain our BUY rating on Technovator with TP HK\$4.3 based on 12x FY15E PE, which implies 20% upside, we adjust down our TP to reflect share dilution from acquisitions and options granted for management, in which we expect TargetCo. to breakeven in FY14E, and we haven't take into account of the profit enhancement from FY15E onwards yet. As we believe more asset injection from parent is coming from 2015 onwards, leading to a completion of energy savings chain, covering three major parties, energy consumption, transmission, and energy generation. And we also see potential spinoff opportunity of Distech Controls in the foreseeable future which is likely a value accretive move to TNI's shareholders, given the 23x high PE disposal PE in 2012 to strategic investor as compared to the company current low teen valuation.

### Exhibit 42: Forecast and Valuation

Year to Dec (US\$ mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	124.2	148.7	180.1	215.3	250.2
Growth (%)	27.4	19.7	21.1	19.5	16.2
Net Profit	13.4	17.1	22.8	31.2	40.1
Growth (%)	28.2	27.4	33.4	36.7	28.4
Diluted EPS (HK\$)	0.201	0.256	0.240	0.328	0.421
EPS growth (%)	(2.1)	27.4	(6.2)	36.7	28.4
Change to previous EPS (%)			(31.2)	(29.6)	(28.4)
Consensus EPS (HK\$)			0.310	0.399	0.488
ROE (%)	18.8	19.8	21.5	23.5	23.8
P/E (x)	17.9	14.0	15.0	10.9	8.5
P/B (x)	3.1	2.5	2.0	1.6	1.3
Yield (%)	0.0	0.0	0.0	0.0	0.0
DPS (HK\$)	0.000	0.000	0.000	0.000	0.000

Source: Bloomberg, OP Research

## Angel hides in details

### Target Co.'s EMC projects turning to revenue

The major business of TFES is waste-heat recovery, whose clients are mainly thermal power plants, others are steel and chemical plants. There are 5 completed EMC projects which are generating revenue from FY13, and 10 EMC projects are under construction which are planned to complete by end FY14E. On top of the projects on hand, TargetCo aims to increase up to 26 projects in total by end of FY17E. The fade out of first EMC project is expected to occur in 2019E. Assuming no new project is added after FY17E, we expect the uptrend of recurring revenue to peak in 2019E.

#### Exhibit 43: TargetCo. – Revenue sharing EMC projects by 2013

No	Project name	Installed capacity	Date of operation	Sharing period (years)
1	Jixi Thermoelectricity Power Plant	45MW (15MW, wattmeter of the plant)	Dec 2011	11
2	Wangkui Sunshine	Thermal 60MW (20MW)	Dec 2012	12
3	Dengta Hongyang Power Plant	81MW (32MW*2+17MW*1)	Dec 2012	6
4	Tang Steel Power Plant	14MW (7MW)	Nov 2013	6
5	Ningan Chemical	46MW (23MW*2)	Dec 2012	10

\*Generally, TargetCo entitled 80% revenue sharing, actual figures may differ case by case  
Source: Company, OP Research

#### Exhibit 44: TargetCo - 10 EMC projects under construction and expect completion by end FY14

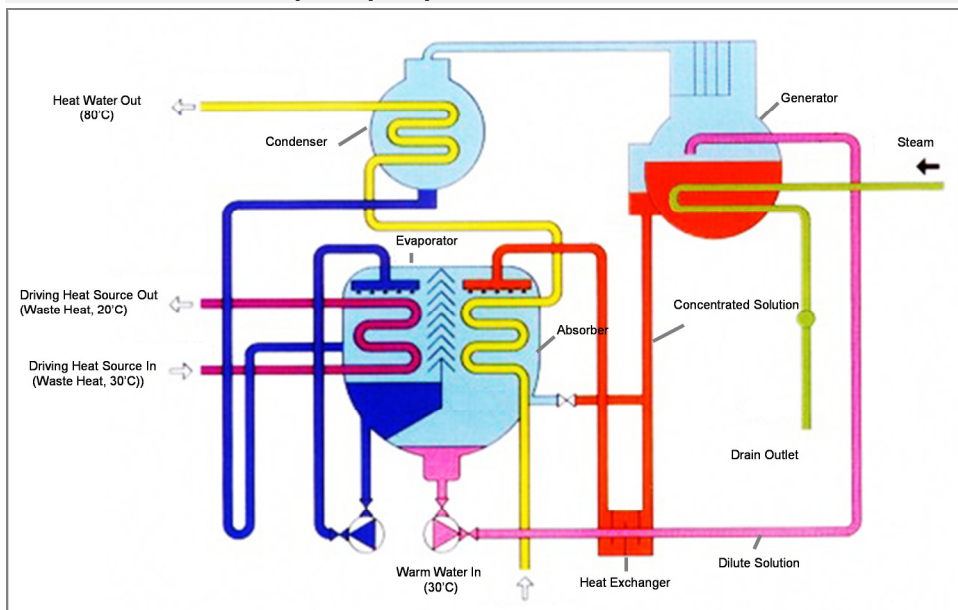
No	Project name	Project nature
1	Tangshan Steel Station No.1 (唐山一鋼站) of Hebei Iron and Steel Company Limited	Waste heat recovery and comprehensive utilization project
2	Tangshan Kailuan Thermoelectricity Co., Ltd. (唐山開灤熱電有限責任公司)	Waste heat recovery and comprehensive utilization project
3	Jinzhou Energy Saving Heat and Electricity Co., Ltd (錦州節能熱電股份有限公司)	Waste heat recovery heating project
4	COFCO Biochemical (AnHui) Co., Ltd	Waste heat recovery and utilization project
5	Zhulu Huada Biological Thermoelectricity Company (涿鹿華達生物熱電有限公司)	Waste heat recovery heating project
6	Ning An Taixiang Energy Development Co., Ltd (寧安市太祥能源開發有限責任公司)	Waste heat recovery heating project
7	Mudanjiang Jiari (牡丹江佳日)	Circulating water heat recovery and heating project with absorption heat pump
8	Guigang Iron & Steel Group Co., Ltd. (貴港鋼鐵集團有限公司)	Moisture removal project with air blow
9	Guangxi Laibin Yongxin Sugar Co., Ltd. (廣西來賓永鑫糖業有限公司)	Waste heat recovery and comprehensive utilization project
10	Ningan Chemical Co., Ltd. (寧安化工有限公司)	Waste heat recovery and utilization project

Source: Company, OP Research

### Recovery of Waste-heat through heat absorption pump system

Traditionally, thermal power plants burns coal as heat source to generate steam. With high pressure steam for power generation, medium pressure steam for heat-supply, the process is known as Combined Heat and Power (CHP), or Cogeneration. Compared to traditional power generation, this technique improves energy efficiency from 33% to 73%. TFES offers a system to further recover low pressure steam (0.17Mpa) as driving heat source for heat-supply, through the application of Heat Absorption Pump System.

**Exhibit 45: Heat absorption pump**



Source: OP research

Under EMC business model, TargetCo.is responsible for the entire upfront investment and substantial capital expenditure which incurred heavy initial cash outflow, in which 70% relates to equipment costs. In return for which they will be entitled to 80% of the relevant revenue during contract term, ranging from 6 to 12 years, average 8 years. The investment cycle is two years on average, thus we are confident Target Co. will be able to turn profitable in 2H14E because most projects under construction are likely to enter maturity stage in FY14/15E.

The expected IRR is above 20%, however, because of the high up-front loading and high technical requirements of tailor-made energy savings facilities, it set a high entry barrier which discourages competition from newcomers.

### Margin expansion from FY16E onwards

TargetCo is using Energy Management Contract (EMC) and Engineering, Procurement and Construction (EPC) as income model, which currently represent 28% and 72% of turnover in FY13. However, EMC accounted for 82% of total operating profits at 35.7% operating margin, compared to 17.6% of TNI in FY13. According to its circular, the number of EMC projects will jump when EPC grows stable, aims to achieve 100% EMC. Therefore, we believe the current operation margin of 12.2% for TargetCo. is likely to improve to above 20% in FY15E, with the expectation of release of operation scale and higher proportion of EMC from 28% in FY13 to 50% in FY15E and 100% by FY18E.

#### Exhibit 46: TargetCo - Project pipeline 2014 Apr-Dec to 2022

Projects	2014	2015	2016	2017	2018	2019	2020	2021	2022
EMC	15	21	24	26	26	25	23	20	17
EPC	3	2	2	1	0	0	0	0	0

Source: Company, OP Research

We expect the M&A is likely to bring up margin expansion for TNI from FY15E onwards. We believe the Target Co. net margin is likely to catch up TNI's level by FY15E and surpass 14.5% from FY15E onwards as higher mixture of high margin EMC projects and economies of scale grow.

### Profit enhancement through stable revenue from EMC

Based on recurring revenue flow of EMC business during the project life cycle, we estimate TargetCo's EMC revenue contribution will continuously increase from RMB31nm in FY13 to RMB57mn/RMB134mn in FY14E/15E. We forecast the revenue based on current energy savings facilities and relevant construction in progress. We assume EPC revenue growth of 20% per year, a conservative estimation given EPC business was up almost 70% yoy in FY13.

Our estimation of TargetCo's total revenue is RMB152mn/RMB249mn in FY14/15E, increase by 38%/63% yoy. As we believe TargetCo will likely achieve economies of scale by FY15E, so we hold that a TNI 14.5% net margin to be a reasonable proxy for TargetCo, hence we estimate profit contribution to be RMB36mn in FY15E, representing 10.6x acquisition PE based on RMB380mn consideration or 17% profit enhancement which is likely to offset the 120mn new share dilution, in our view.



## Maintain BUY for domestic buildings energy savings leader

### Further asset injection on the road

After the injection of TFES from its parent Tsinghua Tongfang (600100 CH), Technovator becomes an integrated energy savings expert for energy end-users and energy generator. Apart from power distribution, Technovator is expert in temperature control via adequate air-conditioning and heat-supply through integrated building automatic systems (iBAS), achieving energy management. We believe the next M&A will focus on Smart City related business, upon completion, Technovator will become a wholly integrated energy savings expert, covering energy generator, city energy transmission grid to energy end-user, creating synergy and further enhance the brand.

### Potential spin-off of overseas arm, Distech Controls

Potential spin-off opportunity of Distech Controls is another catalyst because of realization of intrinsic value. In addition, after the spin-off, Technovator will become a pure domestic energy savings platform, providing more room for further asset injection, facilitate a clearer corporate identity. Overseas market currently represents about 40%.of total turnover.

### High brand recognition in domestic iBAS market

Technovator ranked no. 3 in 2014 April, following international brand SIEMENS and Honeywell, we see a continuous improvement from 2012, when it was no.6. Being a market leader in such a fragmented market, we believe it has a significant competitive advantage to gain more market share.

#### Exhibit 47: 2014 April Top 10 iBAS provider in China

1 <sup>st</sup>		2 <sup>nd</sup>		3 <sup>rd</sup>	
4 <sup>th</sup>		5 <sup>th</sup>		6 <sup>th</sup>	
7 <sup>th</sup>		8 <sup>th</sup>		9 <sup>th</sup>	
10 <sup>th</sup>					

Source: Qianjia, OP Research

### Maintain BUY with TP HK\$4.3

We maintain our BUY rating with lower TP HK\$4.3, to count in dilution effect due to acquisition and options granted to management, based on 12x FY15E PE, representing 40% discount to peers. In which, we expect TargetCo. to breakeven in FY14E, we haven't take into account the profit enhancement from FY15E onwards yet.

#### Exhibit 48: Revisions in key assumptions and forecasts

(US\$ mn)	FY14E			FY15E			FY16E			OP Comments
	New	Old	% Chg	New	Old	% Chg	New	Old	% Chg	
Revenue	180	180	0.0	215	215	0.0	250	250	0.0	
Gross profit	69	69	0.0	84	84	0.0	100	100	0.0	
EBIT	35	35	0.0	47	47	0.0	60	60	0.0	
Net Profit	23	23	0.0	34	34	0.0	44	44	0.0	
Diluted EPS (HK\$)	0.240	0.349	(31.2)	0.328	0.466	(29.6)	0.421	0.589	(28.4)	Reflect share dilution for 120mn from acquisition and 100mn for options to mgt

Source: OP Research

## Key Risks

### Delay in EMC projects of waste heat recovery

Ten EMC projects are expected to start operations in 2H14E or 1H15E, unexpected technical problems or longer than expected adjustment period may limit the relevant revenue. Although the risk is diversified, any delay will harm investors' confidence.

### High profitability attract competition

Since the waste-heat recovery is a new market, the high IRR may attract new comers to compete, which may drive down the net margin, the long lifetime and high proportion of revenue sharing may be eroded by high competition.

### Change in government policy

The energy savings industry is highly supported by China's government policy consistently, any change in government policy may change the industry landscape.

### Liquidity tightening may lower financing leverage

Capital requirement of EMC projects is relatively higher than EPC model, any tightening policy in bank loans will lower the production capacity and limit future growth.

## Financial Summary – Technovator (1206 HK)

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Income Statement (US\$ mn)</b>					
Integrated BAS	94	107	118	129	142
Energy mgt systems	13	22	39	59	77
Control security systems	17	19	22	26	29
Firm alarm systems	0	1	1	2	2
<b>Turnover</b>	<b>124</b>	<b>149</b>	<b>180</b>	<b>215</b>	<b>250</b>
YoY%	27	20	21	20	16
COGS	(80)	(94)	(111)	(131)	(150)
<b>Gross profit</b>	<b>45</b>	<b>55</b>	<b>69</b>	<b>84</b>	<b>100</b>
Gross margin	35.8%	37.0%	38.3%	39.2%	40.1%
Other income	1	1	1	1	1
Selling & distribution	(9)	(11)	(12)	(15)	(17)
Admin	(13)	(15)	(18)	(19)	(20)
R&D	(3)	(5)	(5)	(7)	(8)
Other opex	0	0	0	0	0
<b>Total opex</b>	<b>(26)</b>	<b>(31)</b>	<b>(36)</b>	<b>(40)</b>	<b>(45)</b>
<b>Operating profit (EBIT)</b>	<b>20</b>	<b>25</b>	<b>34</b>	<b>45</b>	<b>57</b>
Operating margin	15.9%	16.9%	18.9%	21.0%	22.7%
Provisions	0	0	0	0	0
Finance costs	(1)	(1)	(2)	(2)	(2)
Profit after financing costs	19	25	32	43	55
Associated companies & JVs	0	0	0	0	0
Pre-tax profit	19	25	32	43	55
Tax	(4)	(6)	(8)	(10)	(13)
Minority interests	(2)	(2)	(2)	(2)	(2)
<b>Net profit</b>	<b>13</b>	<b>17</b>	<b>23</b>	<b>31</b>	<b>40</b>
YoY%	28	27	33	37	28
Net margin	10.8%	11.5%	12.7%	14.5%	16.0%
<b>EBITDA</b>	<b>24</b>	<b>30</b>	<b>41</b>	<b>52</b>	<b>63</b>
EBITDA margin	19.1%	20.2%	22.7%	24.0%	25.2%
<b>EPS (US\$)</b>	<b>0.026</b>	<b>0.033</b>	<b>0.031</b>	<b>0.042</b>	<b>0.054</b>
YoY%	(2)	27	(6)	37	28
DPS (HK\$)	0.000	0.000	0.000	0.000	0.000
<b>Cash Flow (US\$ mn)</b>					
EBITDA	24	30	41	52	63
Chg in working cap	(3)	(13)	(7)	(7)	(8)
Others	1	2	0	0	0
<b>Operating cash</b>	<b>22</b>	<b>18</b>	<b>34</b>	<b>44</b>	<b>55</b>
Interests paid	0	0	(2)	(2)	(2)
Tax	(4)	(6)	(2)	(8)	(10)
<b>Net cash from operations</b>	<b>18</b>	<b>12</b>	<b>31</b>	<b>35</b>	<b>43</b>
Capex	(5)	(4)	(5)	(6)	(7)
Investments	(6)	(10)	(61)	0	0
Dividends received	0	0	0	0	0
Sales of assets	0	0	0	0	0
Interests received	0	1	0	0	0
Others	0	(18)	0	0	0
<b>Investing cash</b>	<b>(10)</b>	<b>(32)</b>	<b>(66)</b>	<b>(6)</b>	<b>(7)</b>
<b>FCF</b>	<b>8</b>	<b>(20)</b>	<b>(35)</b>	<b>29</b>	<b>36</b>
Issue of shares	3	36	61	0	0
Buy-back	0	(1)	0	0	0
Minority interests	(6)	(8)	0	0	0
Dividends paid	0	0	0	0	0
Net change in bank loans	8	7	0	0	0
Others	(0)	(1)	0	0	0
<b>Financing cash</b>	<b>5</b>	<b>33</b>	<b>61</b>	<b>0</b>	<b>0</b>
<b>Net change in cash</b>	<b>12</b>	<b>14</b>	<b>26</b>	<b>29</b>	<b>36</b>
Exchange rate or other Adj	0	(1)	0	0	0
Opening cash	28	41	54	79	108
<b>Closing cash</b>	<b>41</b>	<b>54</b>	<b>79</b>	<b>108</b>	<b>144</b>
<b>CFPS (HK\$)</b>	<b>0.267</b>	<b>0.178</b>	<b>0.326</b>	<b>0.367</b>	<b>0.457</b>

Source: Company, OP Research

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Ratios</b>					
Gross margin (%)	35.8	37.0	38.3	39.2	40.1
Operating margin (%)	15.9	16.9	18.9	21.0	22.7
Net margin (%)	10.8	11.5	12.7	14.5	16.0
Selling & dist'n exp/Sales (%)	7.6	7.4	6.9	6.8	6.7
Admin exp/Sales (%)	10.8	10.4	10.0	8.9	8.1
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0
Effective tax (%)	20.7	23.5	23.5	23.5	23.5
Total debt/equity (%)	19.5	22.3	17.9	14.2	11.2
Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.9	1.9	2.1	2.2	2.4
Quick ratio (x)	1.7	1.7	1.8	2.0	2.2
Inventory T/O (days)	56	63	63	63	63
AR T/O (days)	141	161	161	161	161
AP T/O (days)	202	215	215	215	215
Cash conversion cycle (days)	(5)	10	10	10	10
Asset turnover (x)	1.0	0.8	0.8	0.8	0.8
Financial leverage (x)	1.8	2.1	2.2	2.1	1.9
EBIT margin (%)	15.9	16.9	18.9	21.0	22.7
Interest burden (x)	1.0	1.0	0.9	1.0	1.0
Tax burden (x)	0.7	0.7	0.7	0.7	0.7
<b>Return on equity (%)</b>	<b>18.8</b>	<b>19.8</b>	<b>21.5</b>	<b>23.5</b>	<b>23.8</b>
<b>ROIC (%)</b>	<b>28.7</b>	<b>31.0</b>	<b>41.2</b>	<b>53.1</b>	<b>61.9</b>
<b>Balance Sheet (US\$ mn)</b>					
Fixed assets	7	10	13	17	22
Intangible assets & goodwill	33	37	32	27	24
Associated companies & JVs	0	0	0	0	0
Long-term investments	5	26	27	27	27
Other non-current assets	0	0	0	0	0
<b>Non-current assets</b>	<b>46</b>	<b>74</b>	<b>72</b>	<b>72</b>	<b>73</b>
Inventories	12	16	19	23	26
AR	48	66	80	95	110
Prepayments & deposits	0	0	0	0	0
Other current assets	1	2	2	2	2
Cash	41	54	79	108	144
<b>Current assets</b>	<b>101</b>	<b>138</b>	<b>180</b>	<b>228</b>	<b>283</b>
AP	44	55	65	77	88
Tax	2	2	8	10	13
Accruals & other payables	0	0	0	0	0
Bank loans & leases	8	14	14	14	14
CB & othe debts	0	0	0	0	0
Other current liabilities	0	0	0	0	0
<b>Current liabilities</b>	<b>54</b>	<b>71</b>	<b>88</b>	<b>102</b>	<b>116</b>
Bank loans & leases	7	7	7	7	7
CB & othe debts	0	0	0	0	0
Deferred tax & others	2	38	38	38	38
MI	7	2	3	5	7
<b>Non-current liabilities</b>	<b>16</b>	<b>46</b>	<b>48</b>	<b>50</b>	<b>52</b>
<b>Total net assets</b>	<b>78</b>	<b>95</b>	<b>117</b>	<b>149</b>	<b>189</b>
<b>Shareholder's equity</b>	<b>78</b>	<b>95</b>	<b>117</b>	<b>149</b>	<b>189</b>
Share capital	38	38	38	38	38
Reserves	40	56	79	111	151
<b>BVPS (HK\$)</b>	<b>1.17</b>	<b>1.42</b>	<b>1.76</b>	<b>2.22</b>	<b>2.82</b>
Total debts	15	21	21	21	21
Net cash/(debts)	25	32	58	87	123

**Exhibit 49: Peer Group Comparison**

Company	Ticker	Price	Mkt cap (US\$m)	3-mth		PER FY2	EPS FY1	EPS FY2	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	EV/ Ebitda Hist	EV/ Ebitda Cur Yr	Gross		Net		ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
				avg t/o (US\$m)	PER Hist (x)												Net margin Hist (%)	Net margin (%)						
<b>Technovator</b>	<b>1206 HK</b>	<b>3.60</b>	<b>242</b>	<b>0.5</b>	<b>14.0</b>	<b>15.0</b>	<b>10.9</b>	<b>(6.2)</b>	<b>36.7</b>	<b>18.1</b>	<b>0.83</b>	<b>0.0</b>	<b>0.0</b>	<b>2.54</b>	<b>2.04</b>	<b>61.3</b>	<b>44.3</b>	<b>Net cash</b>	<b>37.0</b>	<b>11.5</b>	<b>19.8</b>	<b>21.5</b>	<b>(5.3)</b>	<b>(12.0)</b>
HSI		24,756.85			11.1	11.5	10.6	(3.6)	8.8	4.7	2.43	3.6	3.4	1.46	1.38						13.2	12.0	6.8	11.9
HSCEI		11,130.20			8.2	7.7	7.1	5.5	8.8	8.0	0.97	3.9	4.1	1.25	1.15						15.3	14.8	7.7	13.8
CSI300		2,350.25			10.8	9.5	8.2	13.8	15.1	14.8	0.64	2.6	2.8	1.53	1.38						14.2	14.6	8.6	8.9
<b>Adjusted sector avg*</b>					<b>N/A</b>	<b>27.1</b>	<b>20.5</b>	<b>37.3</b>	<b>25.6</b>	<b>30.7</b>	<b>1.00</b>	<b>0.7</b>	<b>1.3</b>	<b>3.44</b>	<b>3.43</b>	<b>N/A</b>	<b>12.4</b>	<b>10.1</b>	<b>25.0</b>	<b>6.9</b>	<b>9.7</b>	<b>13.2</b>	<b>5.5</b>	<b>13.2</b>
Shenzhen Das-A	002421 CH	29.32	992	8.1	75.2	54.2	38.9	38.7	39.4	39.0	1.39	0.3	0.5	7.79	7.13	42.1	N/A	0.0	27.6	8.4	11.7	13.7	15.1	29.9
Shanghai Yanhu-A	002178 CH	10.88	656	9.9	87.9	64.8	48.8	35.7	32.7	36.5	1.77	0.3	1.2	5.86	5.48	71.5	40.8	0.0	16.5	5.0	8.0	8.7	12.5	27.4
Honeywell Intl	HON US	94.07	73,614	252.1	18.9	17.0	15.3	11.0	11.2	10.9	1.55	1.9	1.9	3.94	3.75	11.4	9.6	4.2	27.4	10.0	25.0	23.2	1.2	1.3
Johnson Controls	JCI US	48.21	32,019	156.3	28.0	15.2	13.0	84.2	17.0	36.4	0.42	1.8	1.8	2.71	2.51	10.6	10.5	34.9	15.9	2.8	8.4	16.6	(3.4)	6.8
Siemens Ag-Reg	SIE GY	94.59	111,578	141.5	18.6	14.4	12.6	29.0	14.2	17.0	0.85	3.2	3.4	2.83	2.64	12.0	9.8	42.5	27.4	5.6	17.8	18.4	(1.9)	(0.4)
Schneider Electr	SU FP	63.63	49,739	71.5	18.6	16.1	14.3	15.6	12.4	13.0	1.24	2.9	3.0	2.03	1.94	10.8	11.1	19.2	37.8	8.0	10.9	12.2	(7.4)	(5.2)
Henzhen Invt-A	002334 CH	16.11	930	12.3	38.4	32.7	23.8	17.4	37.3	27.5	1.19	0.6	1.2	4.29	4.01	61.4	N/A	0.0	42.1	13.4	10.3	12.8	16.1	21.6
Beijing Dynami-A	600405 CH	12.23	840	38.2	152.9	N/A	N/A	N/A	N/A	N/A	N/A	0.3	N/A	7.16	N/A	58.2	N/A	38.9	33.5	4.0	7.6	N/A	51.7	65.0
Fujian Longking	600388 CH	25.35	1,756	30.1	23.7	23.5	21.4	0.7	9.7	5.4	4.35	1.3	1.4	3.85	3.42	22.0	15.8	1.2	19.6	8.4	16.9	15.2	5.0	0.1
Jiangxi Lianch-A	600363 CH	9.10	654	12.3	25.3	N/A	N/A	N/A	N/A	N/A	N/A	0.2	N/A	2.40	N/A	85.2	N/A	4.1	16.7	9.9	10.0	N/A	10.0	15.3
Nanjing Keyuan-A	002380 CH	26.31	435	4.0	84.0	N/A	N/A	N/A	N/A	N/A	N/A	0.4	N/A	2.92	N/A	112.2	N/A	0.0	39.8	13.4	4.0	N/A	4.2	29.9
Cnlight Co Ltd-A	002076 CH	N/A	N/A	2.7	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.5	N/A	N/A	N/A	N/A	N/A	6.9	N/A	N/A	N/A	N/A	N/A	N/A
Dongguan Kings-A	002638 CH	15.99	971	11.8	57.1	42.6	24.6	33.9	73.3	48.1	0.89	0.4	0.2	2.71	2.55	25.3	N/A	0.0	28.9	9.2	4.8	6.1	13.0	33.5
Jiangsu Transp-A	300284 CH	9.09	708	4.7	23.6	18.1	14.0	30.4	29.7	29.3	0.62	1.1	1.4	2.81	2.41	18.1	12.2	0.0	28.2	11.5	12.6	13.7	3.9	5.2
Unilumin Group-A	300232 CH	24.63	405	6.1	74.6	39.3	28.7	90.0	36.7	49.4	0.80	0.2	N/A	4.24	3.76	37.9	N/A	0.9	25.2	4.2	5.7	9.1	6.6	28.3
Xuzhou Combust-A	300152 CH	11.75	452	11.8	61.8	N/A	N/A	N/A	N/A	N/A	N/A	0.3	N/A	1.98	N/A	45.0	N/A	0.0	25.0	8.2	3.3	N/A	1.9	24.9
Shanghai Zhixi-A	600517 CH	10.79	2,175	10.6	47.4	30.0	21.2	58.0	41.7	55.1	0.54	0.8	0.6	6.20	6.00	31.1	17.5	8.2	20.8	8.7	14.5	21.4	6.2	7.9
Zhejiang Haili-A	002203 CH	11.91	1,493	11.4	32.2	22.1	17.6	45.9	25.0	31.7	0.70	0.8	N/A	3.09	2.89	33.9	N/A	88.8	4.7	2.2	11.6	11.7	8.2	(9.1)
Shenzhen Zowee-A	002369 CH	9.29	740	20.3	50.2	27.3	N/A	83.8	N/A	N/A	N/A	0.6	N/A	3.23	3.26	25.2	N/A	20.1	10.5	4.4	7.1	11.8	2.3	7.8

\* Outliners and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

## Jiangnan Group (1366 HK) – Gross margin expansion story

### Initial Coverage

**BUY**

Close price: **HK\$2.10**

Target Price: **HK\$2.4 (+14%)**

#### Key Data

HKEx code	1366
12 Months High (HK\$)	2.12
12 Month Low (HK\$)	1.00
3M Avg Dail Vol. (mn)	7.17
Issue Share (mn)	3,077.20
Market Cap (HK\$mn)	6,462.12
Fiscal Year	12/2013
Major shareholder (s)	Rui Fubin (55.1%)

Source: Company data, Bloomberg, OP Research  
Closing price are as of 31/7/2014

#### Price Chart



	1mth	3mth	6mth
Absolute %	27.3	30.4	107.7
Rel. MSCI CHINA %	20.0	17.2	95.8

#### Company Profile

Jiangnan Group is a manufacturer of power wires and cables, for power transmission, power distribution and electrical equipment in China.

- Hunting small to mid-size competitors lead to market share expansion.** Jiangsu Zengyang, acquired last year, started to contribute on Aug 2013, being a major driver in 21% Top-line growth in FY13. It is major player in rubber power cables, special cables that enjoys a higher gross margin of 24.8%. The strategy of acquiring special cables can diversify the risk from intensive competition in general cables, which only 15%-17% gross margin, and thus bringing a higher blended gross profit margin. The cables industry in China is fragmented; the top 10 players account for less than 15% of total market share in 2008-2011, and it is huge lag behind that of developed country of more than 60%, in which Jiangnan Group ranked no.3-5 among more than 4,000 players. We believe large scale players can benefit from the consolidation by expanding business through rational acquisition. Recent appointment of a new CEO is regarded as reinforcement of determination to be special cables supplier.
- Capacity expansion captures ultra-high voltage (UHV) wires demand boom help with gross margin.** A major CAPEX in FY14E is construction of new extra high voltage (EHV) power cables production line, in which the capacity will increase from 1,000km to 1,900km. EHV power cables mainly for underground power distribution, is necessary to match the development of UHV power transmission. EHV requires a higher technology standard compared to low-mid voltage power cables. Authorized suppliers of UHV wires and EHV cables to State Grid State Grid Corporation of China (SGCC) and China Southern Power Grid (CSG) is limited to less than 20, JG is one of them. Because of a higher technology barrier, UHV wires and EHV cables enjoys a higher gross profit margin and ASP, we believe it will also help with margin expansion and turnover growth.
- Recovery in South Africa.** We believe sales in South Africa will recover in FY14E, due to expectation of new 5-year procurement contracts with Eskom, with contract size not less than RMB 2bn. This eases concern on pressure from buyer bargaining power by SGCC and CSG.
- Initial BUY. Interim result, contract with Eskom and potential M&A is a near term catalyst.** We initiate our BUY rating on Jiangnan Group with TP HK\$2.4 based on 9x FY14E PE, which implies 14% upside, and 70% discount to its peers listed as A-shares.

#### Exhibit 50: Forecast and Valuation

Year to Dec (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	5,356.4	6,477.3	8,430.6	9,510.5	10,709.3
Growth (%)	8.7	20.9	30.2	12.8	12.6
Net Profit	376.1	503.5	666.4	780.1	896.1
Growth (%)	18.5	33.9	32.3	17.1	14.9
Diluted EPS (HK\$)	0.164	0.205	0.264	0.302	0.347
EPS growth (%)	(1.2)	25.0	29.2	14.3	14.9
Change to previous EPS (%)			51.2	45.3	(34.2)
Consensus EPS (HK\$)			0.259	0.325	0.397
ROE (%)	24.6	24.2	26.1	24.9	23.7
P/E (x)	12.8	10.3	7.9	7.0	6.1
P/B (x)	2.6	2.3	1.8	1.5	1.2
Yield (%)	2.9	2.2	3.1	3.6	4.1
DPS (HK\$)	0.060	0.047	0.066	0.076	0.087

Source: Bloomberg, OP Research

## Market consolidation

### Changing phase of industry

**Large players take advantage in greater financing ability**

As the China cable industry moves from growth phase to shakeout phase, the weakest competitors will be eliminated and only the strong remain. However, because of the high exit costs, we believe small-mid general cables manufacturers will look to sell their business. As a capital intensive industry, large scale players are more capable in financing through bank loans or capital market.

**Exhibit 51: Shakeout of weakest competitors**

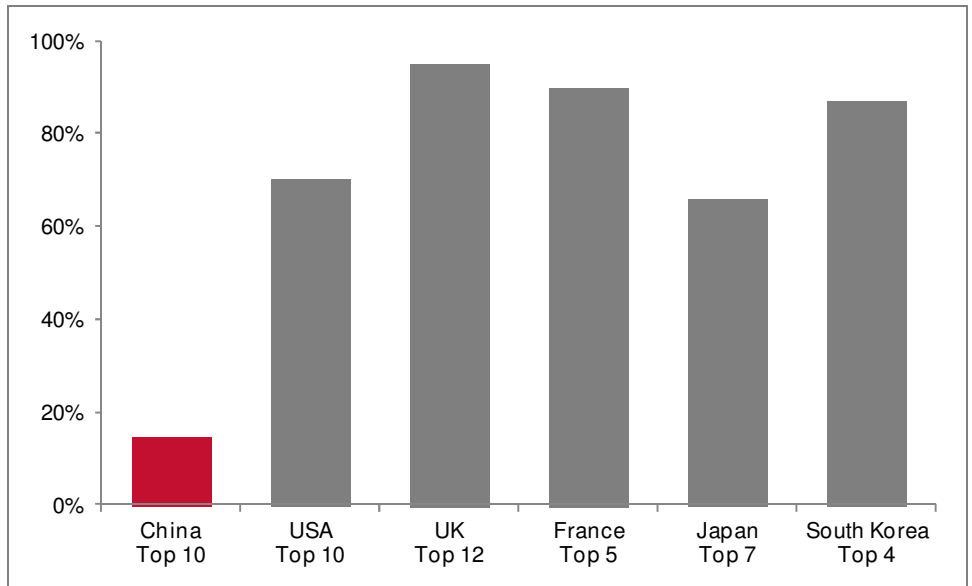
	Development	Growth	<u>Shakeout(current phase)</u>	Maturity	Decline
Users/buyers	-Few (trial of early adopters)	-Growing adopters (trial of product/service)	<u>-Growing selectivity of purchase</u>	-Saturation of users -Repeat purchase reliance	-Drop-off in usage
Competitive conditions	-Few	-Entry of competitors -Attempt to achieve trial -Fight for share -Undifferentiated products/services	<u>-May be many</u> <u>-Likely price-cutting for volume</u> <u>-Shakeout of weakest competitors</u>	-Fight to maintain share -Difficulties in gaining/taking share -Emphasis on efficiency/low cost	-Exit of some competitors -Selective distribution

Source: OP Research

We believe the acquisition of JG last year is a right strategic move. Jiangsu Zengyang, whose principal subsidiary Jiangsu Zhongmei Cable Company, is one of the leaders in rubber cables. The rubber cables is a type of special cables, its flexibility is higher than general power cables using plastic, which are widely used in wind power electricity generation, ship building and mining business. The specialty provides a higher gross margin of 24.8%, compared to general cables at 15-17%.

As mentioned above, the market concentration is significantly lower than in developed countries, the Top 10 in China account for less than 15%, whereas that of US controlled 70% (General Cable, Belden, Corning etc.), the Top 12 in UK take up to 95%, the Top 5 in France account for 90% (Prysmian, Nexans etc.), the Top 7 in Japan share 66% (Furukawa, Sumitomo, Fujikura, Hitachi, Showa etc.), and the Top 4 in South Korea control 87% (LS, Taihan).

**Exhibit 52: Fragmented market in China**



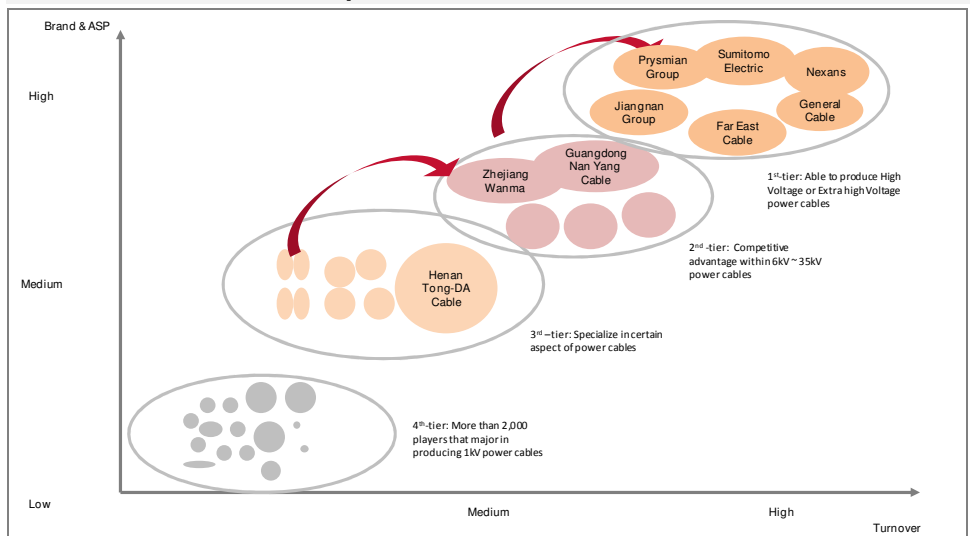
Source: OP Research

**Leading domestic player**

There are more than 4,000 players in the China cable industry, which can be categorized into 4 groups. 1) Majority owned by US enterprises, with large scale turnover greater than RMB3bn, with ability to produce high voltage or extra high voltage power cables (110kV or above), including Nexans (NEX FP EQUITY), General Cable (BGC US EQUITY), Prysmian Group (PRY US EQUITY), Sumitomo Electric, Far East Cable (600869 CH) and JG (1366 HK), about 15 players, 2) Turnover greater than RMB1bn, competitive advantage within 6kV ~ 35kV power cables, including Zhejiang Wanma (002276 CH), Guangdong Nan Yang Cable (002212 CH) etc., about 100 players, 3) Specializing in certain aspects of power cables, growth driven by specific demand, with turnover less than RMB1bn, about 1,800 players, such as Henan Tong-DA cable (002560 CH), 4) More than 2,000 players majoring in production of 1kV power cables, turnover less than RMB5mn.

**Catching up US enterprise in domestic market**

**Exhibit 53: JG listed as Top-tier in domestic market**



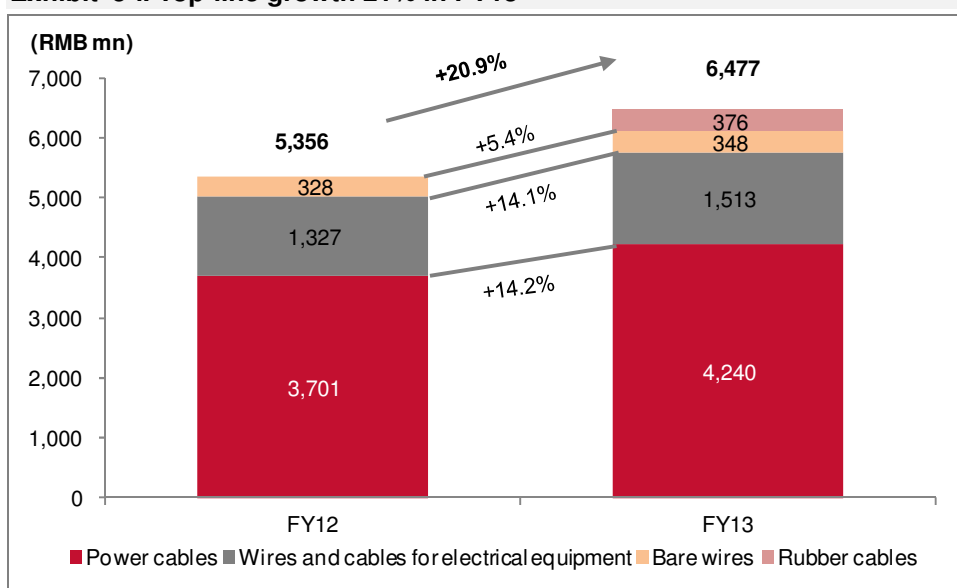
Source: OP Research

We can see that JG is one of the few domestic players in the first group, we believe she can utilize the advantage to grow bigger and enjoy synergy as well as expand customer base by providing more special products.

### Hunter's growth speed up by M&A

JG's Top-line growth by 21% in FY13, in which 7% was driven by rubber cables, the huge increase in volume has compensated certain degree of drop in sales price due to the downward trend in copper and aluminum. Rubber cables only contributed for five months in FY13, we forecast turnover of rubber cables will be doubled in FY14E, the contribution of rubber cables will increased from 6% to 10%, and the growth will be normalized afterwards.

**Exhibit 54: Top-line growth 21% in FY13**



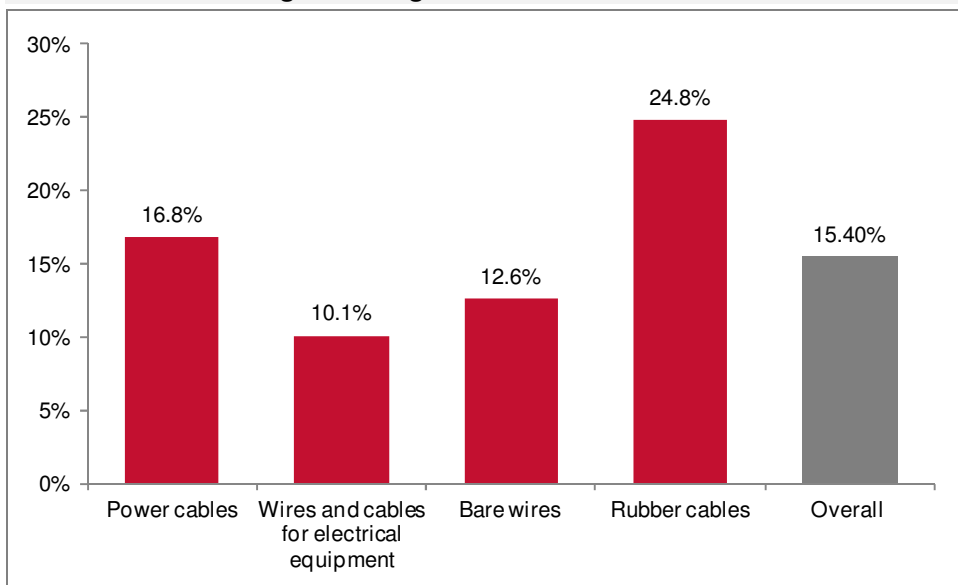
Source: Company, OP Research

**Gross Margin of rubber cables is high at 24.8%**

In terms of profitability, since JG adopted cost-plus model, its gross margin is not affected by the fluctuation in metal prices but mainly decided by products mix. Gross margin of rubber cables is 24.8% in FY13, which is significantly higher than the group overall gross margin at 15.4%. The M&A brings 22.6% growth in net profit, organic growth only account for 11.4%, the company has a budget of RMB500mn for the next acquisition, which size will be 1/5 to 1/4 of it and a special cables producer. JG is target at special cables manufacturers with strong R&D advantage but weak in marketing, we believe the strong sales network and economies of scale can provide synergies.

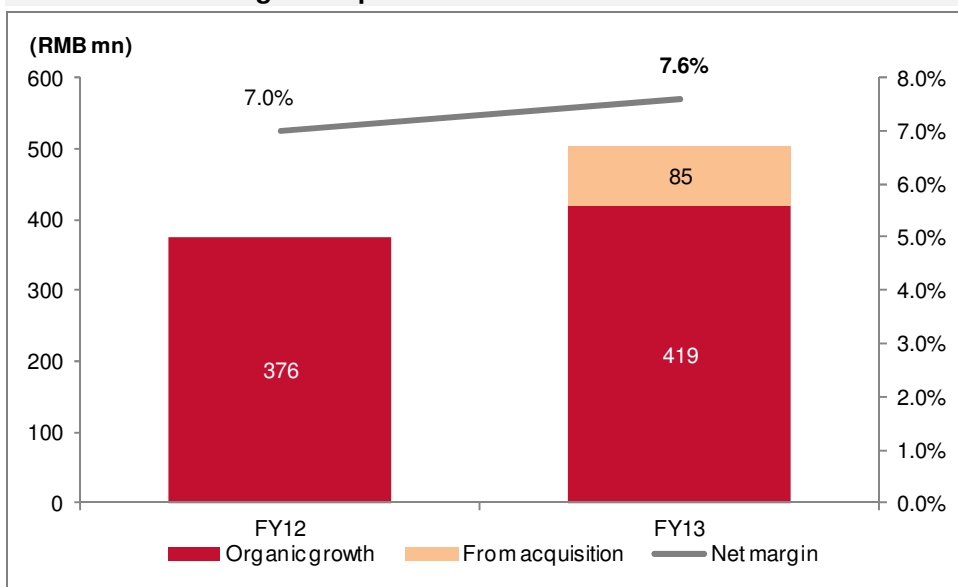


**Exhibit 55: Products gross margin**



Source: Company, OP Research

**Exhibit 56: Net margin composition**



Source: Company, OP Research

## UHV boom drives EHV power cables demand

The investment plan for power grid in 2014 of SGCC rebounded, by 19% to RMB381.5bn. To meet NEA requirements, the construction of ultra-high voltage (UHV, 800kV – 1000kV) power transmission lines need to be rushed. It is expected that the boom will occur in late 2014 to 2020, with CARG 62% in terms of km. JG categorized the relevant sales as bare wires, which is aluminum-based wires. Its gross margin is 13%, a little higher than current average of 12.6%.

Nevertheless, construction of UHV overhead power transmission cables will drive demand in extra high voltage (EHV, 330kV – 800kV) underground copper-based power cables, which are used in power distribution networks. The gross margin of EHV cables is 35%, a lot higher than average gross margin of power cables at 17%. We believe the upgrade of power grid to higher voltage will lead to gross margin expansion. It is expected that large bunch of centralized procurement tender of SGCC will come out in 2H14E, which will impose a stricter requirement of suppliers than localized tender, it will benefit large scale manufacturers with better quality, and we expect the UHV segment will become a growth driver in 2H14E. The current turnover is about 0.5% of total turnover.

As at end of 2013, EHV cable's contribution was higher at around 2.5%. However, because only few high-end cable manufacturers are able to produce EHV power cables, we believe JG is able to capture the growth without tough competition, we expect turnover of EHV cables will be increased to 8% in FY14E. The company plans to add three EHV power cables production lines by RMB70mn CAPEX, to ride on the structural upgrade from low voltage to high voltage. In such, the production capacity of EHV power cables will be increased to 1,900km from current 1,000km. Based on the fact that utilization in FY13 was 18%, this indicating room for more production in coming boom years.

**UHV wires demand CARG 62% in 2014-2020**

### Exhibit 57: CAPEX in FY14E-16E

	Projects	CAPEX (RMB(mn))
FY14	Add 3 EHV power cable production lines (900 km) & Plant and machinery maintenance	120
FY15	Plant and machinery maintenance	50
FY16	Plant and machinery maintenance	50

Source: Company, OP Research

### Exhibit 58: Production capacity and utilization

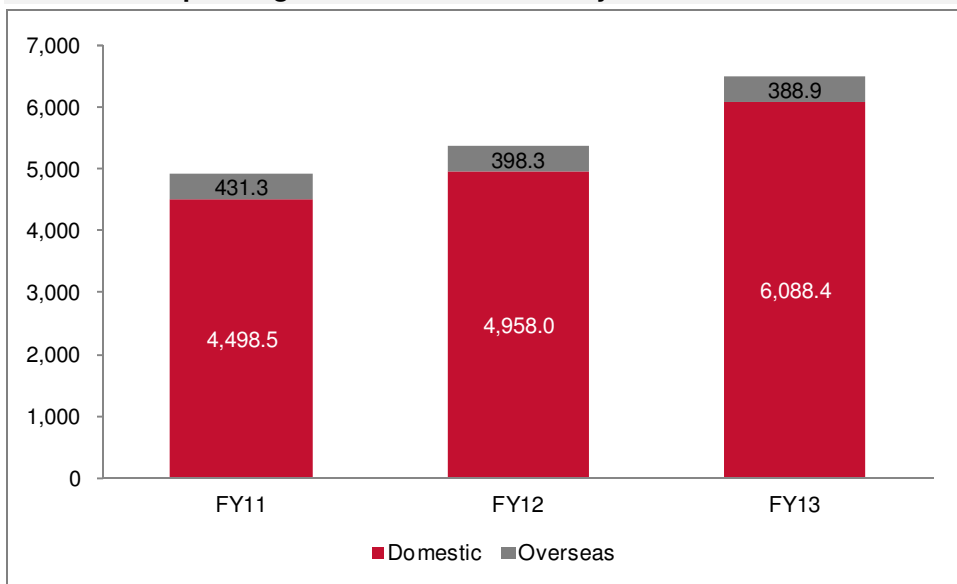
	FY13 Annual capacity	FY13 Utilization rate	FY14 (target) Annual capacity	FY13 vs FY14 Change
Power cables	100,000km	70%	130,000km	+30%
Wires and cables for electrical equipment	833,500km	85%	1,125,000km	+35%
Bare wires	79,500km	50%	90,000km	+13%
Rubber cables	42,000km	70%	54,000km	+28.6%

Source: Company, OP Research

## Recovery in South Africa market

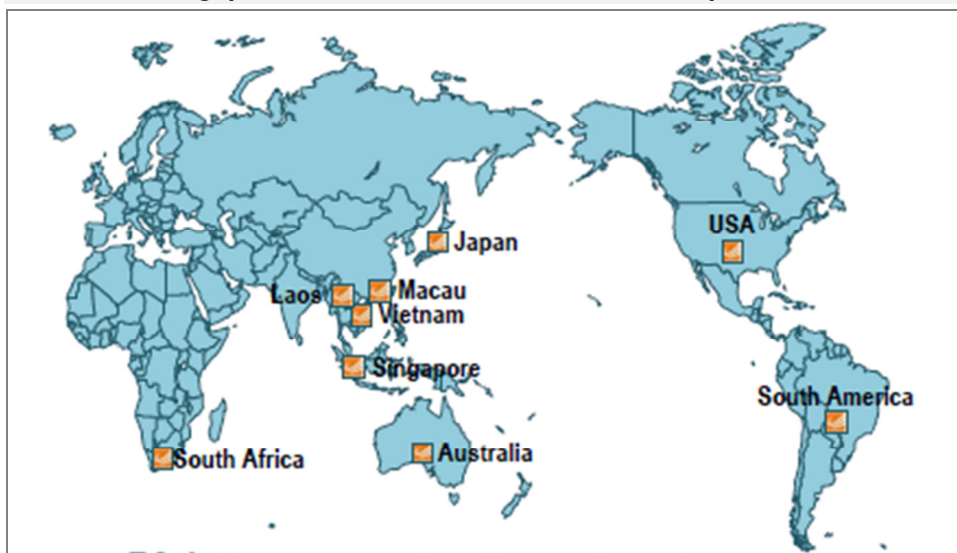
JG is one of the few exporters of power cables in China, overseas market accounted for 6% of total revenue in FY13. Singapore accounted for 50%, South Africa and Vietnam accounted for about 20% respectively, with the remainder taken up by South America, US and Macau.

**Exhibit 59: Squeezing overseas market is likely to recover in FY14E**



Source: Company, OP Research

**Exhibit 60: Singapore, Vietnam and South Africa are Top 3 overseas market**



Source: Company, OP Research

We expect the overseas market turnover will be boost to RMB500mn from RMB388mn in FY13, indicate 28% growth. The assumption is based on resumption of procurement contract with ESKOM, the largest producer of electricity in Africa that provides more than 95% and 60% of electricity in South Africa and Pan-Africa respectively.

In FY07-FY12, JG had a procurement contract with ESKOM, which accounted for 8%/4% of total revenue in FY11/FY12, which is RMB375.4mn/RMB225.0mn respectively. However, since there was no contract in FY13, the revenue from South Africa dropped to RMB84mn from RMB225mn.

During a year of negotiations, the company set up a factory for simple production procedures with capacity up to 10,000km, and a branch office to support after sales service in South Africa. We expect the action could assist JG to resume their cooperation relationship, a new 5-years procurement contract is expected to be signed in 2H14, based on historical record, we estimate the contract size will not be less than RMB2bn which evenly distributed during 5-years term. The related products are mainly aluminum-based bare wires used in overhead power transmission.

***Potential procurement contract  
with ESKOM***

The company target to increase the export proportion to 30% of the overall revenue in five years, the average gross margin in overseas market is 17.3%, higher than that of domestic market by 2 ppt., we believe the long-term strategy will lead to further margin improvement.

## Financial Forecasts

### Turnover CAGR 22% growth and Net Profit CARG 19% growth over FY13-16E

We forecast a topline CAGR 19% over FY13-16E in which highest growth will occur in FY14E because of the M&A. Together with market share expansion and demand in ultra-high voltage (UHV) & extra-high voltage (EHV) power cables boost, we estimate the major driver is increase in sales volume, where ASP will quite stable with single digit growth on average. We expect the growth in ASP of copper-based cables will be slow because the higher gross margin of high-end product (from low voltage to high voltage) will be offset by the fluctuations in copper price, which remains weak in 1H14. On the other hand, the growth in ASP of aluminum-based cables will be moderate because the proportion of UHV wires will increase and with help from recovery of aluminum price.

We expect the net profit will grow at CAGR 19% in FY13-16E, thanks to better product mix of higher voltage cables and special cables will growth faster, which will lead to mild net margin improvement. We have not factored in future M&A, as we believe another M&A is coming soon.

On 9 April 2014, JG announced the issue of 150mn shares of unlisted warrants to six individuals, all from Mainland China and Hong Kong. The warrants are issued at \$0.01 per share with exercise price at \$1.7 per share. Our FY14E/15E EPS estimation of RMB0.216 and RMB0.250 are based on the fully diluted EPS, which assume all warrants are fully exercised.

### Higher voltage cables & wires lead to gross margin expansion

Despite the volatility in ASP which was affected by metal price, we believe the gross margin will improve steadily in power cables, bare wires and rubber cables. The improvement in power cables is based on the assumption of synergy release between origin production lines and acquired production lines, as well as more EHV power cables, which gross margin is 35%, compared to general power cables of 17%. We estimate the gross margin of bare wires will be capped at 13%, which is the gross margin of UHV wires. Gross margin of rubber cables will be slightly improve to 25%. All in all, the blended gross margin will improve from 15.4% in FY13 to 16.1% in FY14E and 16.2% in FY15E.

### CAPEX

As mentioned above, the major organic expansion plan of JG is adding three EHV power cables production lines by RMB70mn, and thus the capacity will be increased to 1,900km from current 1,000km. With RMB50mn for other maintenance, total CAPEX for FY14E will be RMB120mn.

***Margin expansion is expected after acquisition***

## Initiate BUY on industry structural change

**Gross margin expansion:** With the help of acquired rubber cables, and increasing demand for high voltage products due to construction of ultra-high voltage (UHV) power grid and substantial power distribution upgrade, we expect the gross margin of power cables and bare wires segment will be increased, overall blended gross margin will be improved from 15.4% in FY13 to 16.1% in FY14E and 16.2% in FY15E. The improvement of margin is estimated based on increasing demand and production capacity expansion on extra-high voltage (EHV) power cables which is enjoying a higher gross profit margin of 35%, driven by increasing grid investment on UHV power transmission wires by SGCC.

**Substantial development in overseas market:** South Africa market's contribution to revenue dropped from 4.2% to 1.3% in FY13, it was due to the end of the five years contract with Eskom, which is the largest producer of electricity in Africa, providing more than 60% of electricity in Africa. We expect the procurement contract will be resumed in 2H14, with contract size not less than RMB2bn for five-year term. The overseas development will help in margin improvement and customer base diversification, which can diversify the risks of slowdown in power grid investment in China, JG target overseas market will account for 30% of turnover in 5 years.

**Market consolidation leads to M&A and market share gain:** JG is taking active role in M&A, from the acquisition of Jiangsu Zengyang, we believe the ability of JG to seek for more good deal that will bring synergy and economies of scale to the group. We expect during merger, the segment gross margin may squeeze, but a year should be enough for the business to release synergy, and the higher GM of special cables should be able to outweigh the squeezing effect and bring margin expansion ultimately. Although the next M&A is not yet confirmed, but we expect it will be in 2H14E to FY15E, the continuous M&A is a major growth driver in soon future.

**Initial BUY with TP HK\$2.4:** We initiate our BUY rating on Jiangnan Group with TP HK\$2.4 based on 9x FY14E PE, which implies 14% upside, and 70% discount to its peers listed as A-shares.

## Key Risks

### Volatility of Copper and aluminum price

Since JG is adopting a cost-plus model based on copper or aluminum price, rally in copper/aluminum will positively impact top-line and benefit to net profit margin, downtrend of metal price may squeeze net profit margin vice versa.

### Delay in UHV power grid upgrade

UHV power grid will drive a power grid upgrade, not only as long distance power transmission but also as regional power distribution. However, delay of government approval may lead to slowdown in UHV power cables demand.

### Uncertainty in the tender with Eskom

We expect the contract will be resumed in 2H14E with contract size RMB2bn, any delay of contract and uncertainty in contract size will affect the overseas recovery.

### Interest rate jump and liquidity tighten

It is a capital-intensive industry, the net debt reach RMB1.2bn, net debt ratio is 20%, interest coverage is 4x, which is still at heavy position, however, rise in interest rate may squeeze net profit margin.

### Failure in future acquisitions

We expect there will be more M&A coming, sooner at 2H14E to FY15E, timeline of future acquisition is still on the way, the pace of M&A may be slower than expected.

## Appendix I – Key Management Profiles

**Mr. Rui Fubin (芮福彬), Founder/ Chairman:** Aged 65, Mr. Rui is mainly responsible for strategic planning and supervision of the overall business and operation. Mr. Rui has more than 30 years of management experience in the wire and cable industry. He was the deputy mayor of Guanlin Town People's Government of Yixing City from 1994 to 1998. Mr. Rui completed two-year's adult education in the Nanjing University of Finance and Economics (formerly known as Jiangsu Cadre's Institute of Economic and Management) on a part-time basis in May 1992, majoring in industrial economic management. Mr. Rui was qualified as a senior economist by the Jiangsu Province Personnel Department in November 2007.

**Mr. Chu Hui (儲輝), CEO:** Aged 42, Mr. Chu is the Chairman of Jiangsu Zhongmei Cable since May 2005, which was acquired by JG last year and become wholly-owned subsidiary. He was son-in-law of Mr. Rui Fubin (Chairman). Mr. Chu has more than 20 years' experience in the wire and cable industry. He was the vice chairman of the 2<sup>nd</sup> Governing Council of the Jiangsu Province Cola Mining Machinery Industry Association. Mr. Chu was qualified as a senior economist by the Jiangsu Province Personnel Department in 2005 and obtained a master of business administration in Southeast University.

**Ms. Xia Yafang (夏亞芳), Executive Vice President:** Aged 41, Ms. Xia is responsible for the daily operations. She was Chief engineer of the company in 2011. She is experienced in R&D and management for 20 years in the industry. Ms. Xia graduated from Nanjing Jinling Institute of Technology (formerly known as Nanjing Polytechnic University) with an associate degree in mechanical and electrical engineering in July 1992. Ms. Xia was qualified as a senior economist in November 2005 and senior engineer in September 2007, both by the Jiangsu Province Personnel Department. Ms. Xia is the spouse of Mr. Han Wei, the vice general manager.

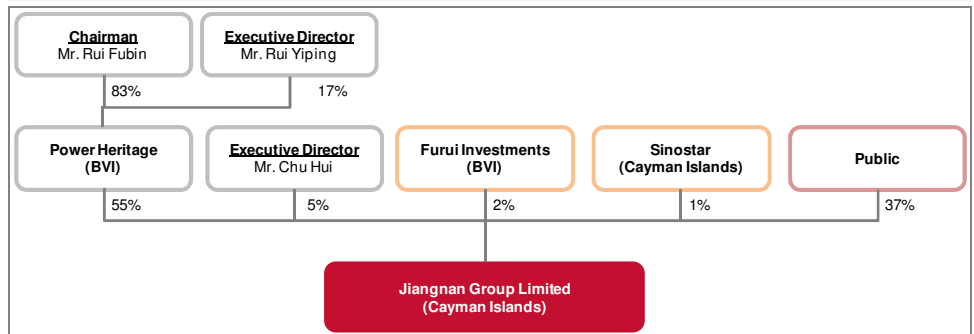
**Mr. Jiang Yongwie (蔣永衛), Vice President:** Aged 47, Mr. Jiang is responsible for production management, with more than 20 years' experience in production and equipment management experience in the industry. Mr. Jiang graduated from Southeast University with a master degree in business administration in July 2004. Mr. Jiang was qualified as a senior economist in November 2005 by the Jiangsu Province Personnel Department. The spouse of Mr. Jiang is the niece of Mr. Rui Fubin.

**Mr. Chan Man Kiu (陳文喬), CFO/Company Secretary:** Aged 52, Mr. Chan has over 26 years of experience in the field of finance and operations, He was deputy chief operating officer in Xinhua Sports and Entertainment, and finance director and managing director in business development of Xinhua Finance. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants. He obtained his Professional Diploma in Accountancy from the Hong Kong Polytechnic in 1984 and EMBA from the City University of Hong Kong in 2003.



## Appendix II – Shareholding Structure

**Exhibit 61: Shareholding Structure**



Source: Company, OP Research

## Appendix III – Customer Base

Exhibit 62: State grids are major customers

	Key customers	Flagship projects
Energy sector 40% of FY13 revenue	    	<p>Yunnan to Guangdong ±800kV UHV DC</p> <p>Xiluodu to Jinhua ±800kV UHV DC</p> <p>East Lanzhou-Tianshui-Baoji 750kV</p> <p>Gezhouba Hydro-electric power</p>
Industrial sector 27% of FY13 revenue	     	<p>The "Shenzhou" project</p> <p>Shanghai Baosteel projects</p> <p>West-East Gas Pipeline Project</p> <p>South-to-North Water Transfer</p>
Infrastructure sector 18% of FY13 revenue	     	<p>Hangzhou Bay Bridge platform</p> <p>High speed railway</p> <p>Fuzhou to Xiamen</p> <p>Shanghai to Shenzhen</p> <p>Beijing to Shanghai</p>
Property sector 15% of FY13 revenue	    	<p>The general headquarters of the People's Bank of China</p> <p>2008 Olympic Stadium</p> <p>Shanghai IFC</p>

Source: Company, OP Research

## Financial Summary – Jiangnan Group (1366 HK)

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Income Statement (RMB mn)</b>					
Power cables	3,701	4,240	5,431	6,246	6,967
Wires and cables for electrical equipment	1,327	1,514	1,635	1,766	1,907
Bare wires	328	348	538	672	1,008
Rubber cables	0	376	827	827	827
<b>Turnover</b>	<b>5,356</b>	<b>6,477</b>	<b>8,431</b>	<b>9,511</b>	<b>10,709</b>
YoY%	9	21	30	13	13
COGS	(4,514)	(5,477)	(7,071)	(7,976)	(8,994)
<b>Gross profit</b>	<b>842</b>	<b>1,000</b>	<b>1,360</b>	<b>1,534</b>	<b>1,715</b>
Gross margin	15.7%	15.4%	16.1%	16.1%	16.0%
Other income	1	6	2	2	2
Selling & distribution	(94)	(110)	(140)	(155)	(172)
Admin	(86)	(133)	(176)	(196)	(218)
R&D	(13)	(17)	(22)	(25)	(28)
Other opex	(19)	(1)	(1)	0	0
<b>Total opex</b>	<b>(212)</b>	<b>(260)</b>	<b>(339)</b>	<b>(376)</b>	<b>(418)</b>
<b>Operating profit (EBIT)</b>	<b>632</b>	<b>746</b>	<b>1,023</b>	<b>1,161</b>	<b>1,299</b>
Operating margin	11.8%	11.5%	12.1%	12.2%	12.1%
Provisions	(23)	(6)	0	0	0
Interest Income	29	21	24	25	28
Finance costs	(182)	(195)	(235)	(235)	(235)
Profit after financing costs	456	566	812	951	1,092
Associated companies & JVs	0	39	0	0	0
Pre-tax profit	456	605	812	951	1,092
Tax	(80)	(102)	(146)	(171)	(196)
Minority interests	0	0	0	0	0
<b>Net profit</b>	<b>376</b>	<b>504</b>	<b>666</b>	<b>780</b>	<b>896</b>
YoY%	18	34	32	17	15
Net margin	7.0%	7.8%	7.9%	8.2%	8.4%
<b>EBITDA</b>	<b>668</b>	<b>797</b>	<b>1,080</b>	<b>1,226</b>	<b>1,369</b>
EBITDA margin	12.5%	12.3%	12.8%	12.9%	12.8%
<b>EPS (RMB)</b>	<b>0.131</b>	<b>0.164</b>	<b>0.211</b>	<b>0.242</b>	<b>0.278</b>
YoY%	(1)	25	29	14	15
DPS (HK\$)	0.060	0.047	0.066	0.076	0.087
<b>Year to Dec (mn)</b>					
<b>Cash Flow (RMB mn)</b>					
EBITDA	668	797	1,080	1,226	1,369
Chg in working cap	(403)	(20)	(679)	(388)	(437)
Others	1	(0)	0	0	0
<b>Operating cash</b>	<b>266</b>	<b>777</b>	<b>401</b>	<b>838</b>	<b>932</b>
Interests paid	0	0	0	0	0
Tax	(68)	(78)	(54)	(146)	(171)
<b>Net cash from operations</b>	<b>198</b>	<b>700</b>	<b>347</b>	<b>692</b>	<b>761</b>
Capex	(123)	(23)	(120)	(50)	(50)
Investments	0	(387)	0	0	0
Dividends received	0	0	0	0	0
Sales of assets	10	6	0	0	0
Interests received	29	21	24	25	28
Others	(304)	79	0	0	0
<b>Investing cash</b>	<b>(388)</b>	<b>(305)</b>	<b>(96)</b>	<b>(25)</b>	<b>(22)</b>
<b>FCF</b>	<b>(190)</b>	<b>395</b>	<b>251</b>	<b>667</b>	<b>739</b>
Issue of shares	370	0	2	0	0
Buy-back	0	0	0	0	0
Minority interests	0	0	0	0	0
Dividends paid	(47)	(88)	(130)	(170)	(194)
Net change in bank loans	533	452	0	0	0
Others	(206)	(198)	(235)	(235)	(235)
<b>Financing cash</b>	<b>650</b>	<b>166</b>	<b>(363)</b>	<b>(404)</b>	<b>(429)</b>
<b>Net change in cash</b>	<b>460</b>	<b>560</b>	<b>(112)</b>	<b>263</b>	<b>310</b>
Exchange rate or other Adj	(0)	(16)	0	0	0
Opening cash	678	1,138	1,683	1,571	1,833
<b>Closing cash</b>	<b>1,138</b>	<b>1,683</b>	<b>1,571</b>	<b>1,833</b>	<b>2,143</b>
<b>CFPS (HK\$)</b>	<b>0.086</b>	<b>0.284</b>	<b>0.137</b>	<b>0.268</b>	<b>0.295</b>

Source: Company, OP Research

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Ratios</b>					
Gross margin (%)	15.7	15.4	16.1	16.1	16.0
Operating margin (%)	11.8	11.5	12.1	12.2	12.1
Net margin (%)	7.0	7.8	7.9	8.2	8.4
Selling & dist'n exp/Sales (%)	1.8	1.7	1.7	1.6	1.6
Admin exp/Sales (%)	1.6	2.0	2.1	2.1	2.0
Payout ratio (%)	36.7	23.0	25.0	25.0	25.0
Effective tax (%)	17.5	18.0	18.0	18.0	18.0
Total debt/equity (%)	102.9	128.0	103.6	85.2	70.7
Net debt/equity (%)	2.3	19.1	19.4	8.3	Net cash
Current ratio (x)	1.4	1.3	1.3	1.4	1.5
Quick ratio (x)	1.1	0.9	0.9	1.0	1.0
Inventory T/O (days)	81	123	123	123	123
AR T/O (days)	125	131	135	137	139
AP T/O (days)	114	148	148	148	148
Cash conversion cycle (days)	92	106	109	111	113
Asset turnover (x)	1.1	1.0	1.0	1.0	1.0
Financial leverage (x)	3.1	3.1	3.2	3.0	2.7
EBIT margin (%)	11.8	11.5	12.1	12.2	12.1
Interest burden (x)	0.7	0.8	0.8	0.8	0.8
Tax burden (x)	0.8	0.8	0.8	0.8	0.8
<b>Return on equity (%)</b>	<b>24.6</b>	<b>24.2</b>	<b>26.1</b>	<b>24.9</b>	<b>23.7</b>
<b>ROIC (%)</b>	<b>30.9</b>	<b>26.2</b>	<b>27.4</b>	<b>26.7</b>	<b>27.1</b>
<b>Year to Dec (mn)</b>					
<b>Balance Sheet (RMB mn)</b>					
Fixed assets	473	633	702	693	679
Intangible assets & goodwill	79	208	202	196	189
Associated companies & JVs	0	46	46	46	46
Long-term investments	3	4	4	4	4
Other non-current assets	5	7	7	7	7
<b>Non-current assets</b>	<b>560</b>	<b>896</b>	<b>959</b>	<b>944</b>	<b>925</b>
Inventories	1,003	1,842	2,373	2,677	3,019
AR	1,829	2,323	3,118	3,570	4,078
Prepayments & deposits	0	0	0	0	0
Other current assets	757	813	813	813	813
Cash	1,138	1,683	1,571	1,833	2,143
<b>Current assets</b>	<b>4,727</b>	<b>6,661</b>	<b>7,875</b>	<b>8,893</b>	<b>10,053</b>
AP	1,405	2,223	2,870	3,238	3,651
Tax	33	54	146	171	196
Accruals & other payables	0	0	0	0	0
Bank loans & leases	1,935	2,922	2,922	2,922	2,922
CB & othe debts	1	4	4	4	4
Other current liabilities	0	0	0	0	0
<b>Current liabilities</b>	<b>3,373</b>	<b>5,203</b>	<b>5,942</b>	<b>6,334</b>	<b>6,773</b>
Bank loans & leases	0	0	0	0	0
CB & othe debts	0	0	0	0	0
Deferred tax & others	33	68	68	68	68
MI	0	0	0	0	0
<b>Non-current liabilities</b>	<b>33</b>	<b>68</b>	<b>68</b>	<b>68</b>	<b>68</b>
<b>Total net assets</b>	<b>1,881</b>	<b>2,286</b>	<b>2,824</b>	<b>3,434</b>	<b>4,136</b>
<b>Shareholder's equity</b>	<b>1,881</b>	<b>2,286</b>	<b>2,824</b>	<b>3,434</b>	<b>4,136</b>
Share capital	25	25	25	25	25
Reserves	1,856	2,261	2,799	3,409	4,111
<b>BVPS (HK\$)</b>	<b>0.82</b>	<b>0.93</b>	<b>1.15</b>	<b>1.40</b>	<b>1.68</b>
Total debts	1,936	2,926	2,926	2,926	2,926
Net cash/(debts)	(43)	(436)	(548)	(285)	25

Exhibit 63: Peer Group Comparison

Company	Ticker	Price	Mkt cap (US\$m)	3-mth		PER FY2	EPS FY1	EPS FY2	3-Yr EPS Cagr (%)	PER YoY%	EPS YoY%	3-Yr EPS Cagr (%)	PEG (x)	Div	Div	P/B	P/B	EV/ Ebitda	EV/ Ebitda	Net gearing	Gross margin	Net margin	ROE Hist	ROE FY1 (%)	Sh px 1-mth	Sh px 3-mth
				avg t/o	PER Hist									Div yld	Div yld											
Jiangnan Group	1366 HK	2.10	828	1.9	10.2	7.5	6.3	36.5	18.7	23.7	0.3	2.2	3.3	2.3	1.8	8.6	6.3	19.1	15.4	7.8	24.2	27.4	16.6	10.5		
HSI		24,756.85			11.0	11.5	10.6	(4.5)	8.5	4.3	2.7	3.6	3.4	1.4	1.4							13.2	12.0	6.7	10.3	
HSCEI		11,130.20			8.2	7.8	7.1	5.8	8.9	8.0	1.0	3.9	4.1	1.3	1.1							15.3	14.8	7.0	12.0	
CSI300		2,350.25			10.7	9.4	8.2	13.5	15.2	14.5	0.6	2.6	2.8	1.5	1.4							14.3	14.6	8.2	8.2	
<b>Adjusted sector avg*</b>					<b>29.3</b>	<b>23.2</b>	<b>16.4</b>	<b>20.9</b>	<b>51.8</b>	<b>(103.4)</b>	<b>1.0</b>	<b>1.5</b>	<b>2.5</b>	<b>2.3</b>	<b>1.5</b>	<b>18.9</b>	<b>7.2</b>	<b>48.3</b>	<b>14.1</b>	<b>3.1</b>	<b>6.2</b>	<b>8.0</b>	<b>(0.7)</b>	<b>3.4</b>		
GUANGDONG NAN-A	002212 CH	7.03	588	18.3	73.5	N/A	N/A	N/A	N/A	N/A	N/A	0.2	N/A	2.2	N/A	37.3	N/A	41.8	12.5	2.7	2.4	N/A	4.9	61.2		
ZHEJIANG WANMA-A	002276 CH	8.70	1,340	19.4	35.0	28.5	24.0	22.9	18.6	18.6	1.5	0.6	N/A	3.1	N/A	25.8	N/A	12.2	14.8	4.6	9.1	N/A	11.2	23.9		
JIANGSU ZHONGC-A	002471 CH	8.75	728	10.0	27.5	26.0	23.3	6.1	11.4	N/A	N/A	1.1	N/A	2.9	N/A	18.2	N/A	85.7	15.1	3.7	10.8	N/A	6.4	23.3		
HENAN TONG-DA-A	002560 CH	16.80	385	1.1	30.1	N/A	N/A	N/A	N/A	N/A	N/A	1.1	N/A	1.8	N/A	20.5	N/A	15.4	17.5	6.2	4.8	N/A	(0.9)	(0.9)		
FAR EAST SMART-A	600869 CH	10.04	1,630	10.7	32.6	N/A	N/A	N/A	N/A	N/A	N/A	1.0	N/A	3.3	N/A	30.1	N/A	69.3	16.4	2.6	10.4	N/A	21.8	21.6		
NEXANS SA	NEX FP	33.97	1,793	4.4	N/A	26.1	12.3	N/A	112.0	(168.5)	N/A	N/A	1.2	0.8	0.8	4.9	6.3	23.1	11.3	(5.0)	(10.5)	3.3	(11.3)	(26.3)		
PRYSMIAN SPA	PRY IM	15.92	4,389	15.7	21.2	15.9	11.7	33.8	35.1	29.3	0.5	2.8	2.8	2.8	2.6	7.3	8.4	70.0	37.2	2.0	16.6	15.9	(4.4)	(7.0)		
GEN CABLE CORP	BGC US	22.04	1,063	17.3	N/A	19.6	10.8	N/A	82.1	(293.0)	N/A	3.4	3.4	1.1	1.0	6.9	6.9	69.3	11.0	(0.3)	(30.0)	4.9	(11.0)	(11.2)		

\* Outliers and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

## Boer Power (1685HK) – Expands sales network

### Initial Coverage

**BUY**

Close price: **HK\$9.45**  
Target Price: **HK\$10.8(+14%)**

#### Key Data

HKEx code	1685
12 Months High (HK\$)	11.64
12 Month Low (HK\$)	4.98
3M Avg Dail Vol. (mn)	0.47
Issue Share (mn)	776.47
Market Cap (HK\$m)	7,337.63
Fiscal Year	12/2013
Major shareholder (s)	Qian Yixiang (67.0%)

Source: Company data, Bloomberg, OP Research  
Closing price are as of 31/7/2014

#### Price Chart



#### Company Profile

Boer Power is a leading China integrated electrical distribution systems design company, expanding business into energy efficiency systems, it also manufactures power distribution components

- **Strong Backlog is a proxy of high growth in FY14E.** The guidance by management is more aggressive than before, indicating a high confidence based on the large amount of backlog on hand at the end of FY13, RMB1,810mn, jumped 86% yoy. It is estimated 70% of backlog is likely to be completed in FY14E, similar to the percentage in past years. We believe it will drive the earnings growth to accelerate from lower than 20% to 30%. We forecast a CAGR 32% in FY14-16E which mainly driven by intelligent electrical distribution (iEDS) and spare parts and components (CSP).
- **Penetration in data center to support high margin.** Leveraging on its existing customer base in iEDS, BP has established a relationship with domestic data center and telecommunication giants, like China Unicom, China Mobile, Centrin Data Systems (中金數據系統), GDS (萬國數據), the demand of energy efficiency in Data Centers is rising due to existing over-cooling problem, and encouragement on lower PUE(Ratio of Total facility energy to IT Equipment Energy). Energy efficient solution (EES) segment has experienced a high growth at 57% in FY13, however we expect the growth will slow down in FY14E based on a smaller proportion in Backlog.
- **Sales network expansion and new products will drive CSP turnover, we believe success of smart home products will open a new market in future.** Number of distributors expands from about 180 in FY13 to 420 in 1H14E, up 1.33x, a separate sales network for smart home products was also set up. We see sales expansion is a major strategy, we expect a high growth of spare parts and components (CSP) turnover at 87%. Another key product is solid insulated Ring Main Unit (RMU) which is a core component in power distribution, considered as environmental friendly and stable relative to gas insulated type. Penetration of solid insulated type is estimated to be increased from 5% in 2013 to 25% in 2015.
- **Initiate BUY.** Our TP HK\$10.8 is based on 15x FY14E PE, discount 15% to its global peers, in our view, the valuation is justified by 32% earnings three-year CAGR.

#### Exhibit 64: Forecast and Valuation

Year to Dec (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	1,221.2	1,354.0	1,865.7	2,222.2	2,461.3
Growth (%)	20.4	10.9	37.8	19.1	10.8
Net Profit	293.4	344.9	446.7	531.7	591.3
Growth (%)	16.0	17.6	29.5	19.0	11.2
Diluted EPS (HK\$)	0.480	0.570	0.719	0.856	0.952
EPS growth (%)	17.4	18.8	26.2	19.0	11.2
Change to previous EPS (%)					
Consensus EPS (HK\$)			0.768	0.987	1.193
ROE (%)	18.1	18.7	21.4	21.9	20.6
P/E (x)	19.7	16.6	13.1	11.0	9.9
P/B (x)	3.3	2.9	2.6	2.2	1.9
Yield (%)	1.3	3.3	1.9	2.3	2.5
DPS (HK\$)	0.120	0.310	0.180	0.214	0.238

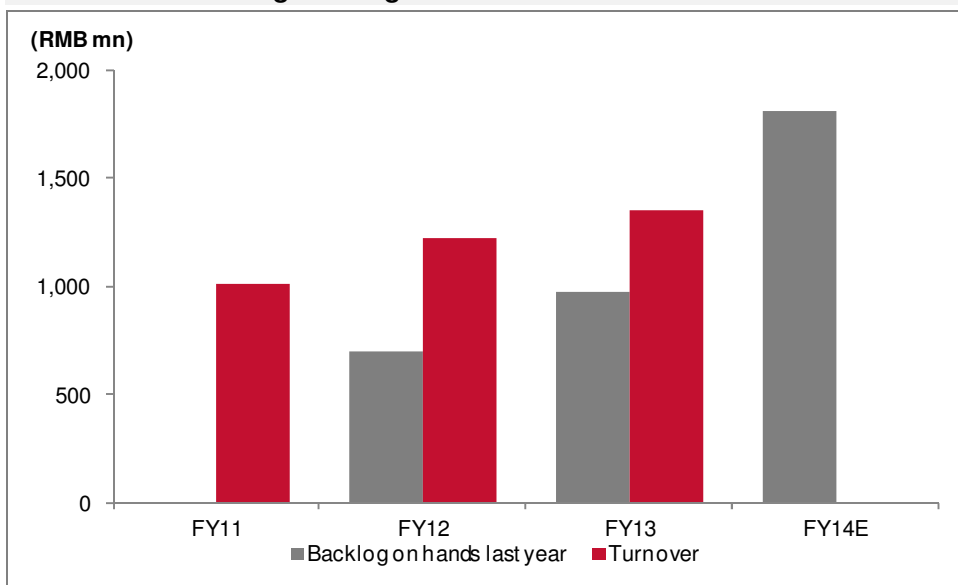
Source: Bloomberg, OP Research

## Strong backlog

### Jumped by 86% is a sign of rapid growth

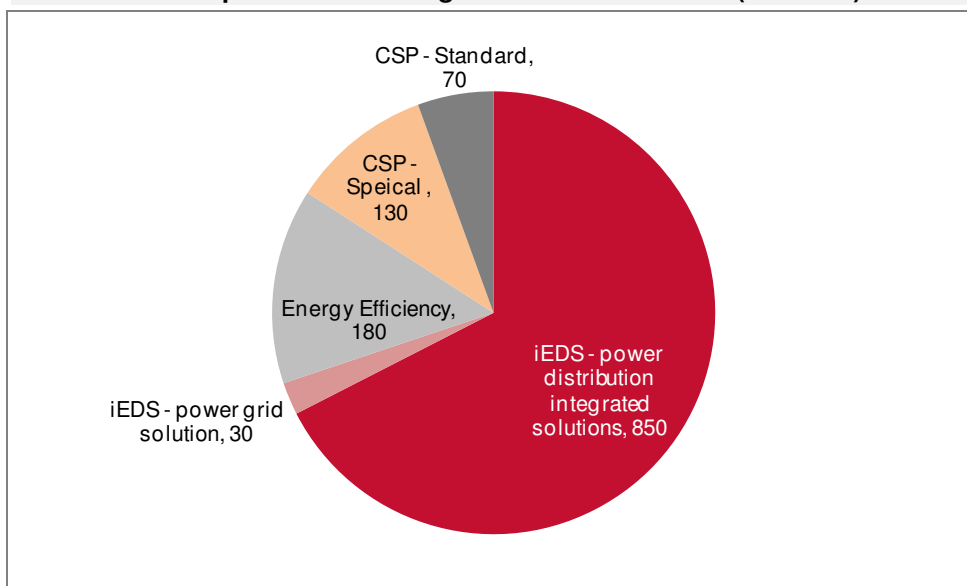
As at the end of FY13, Boer Power (BP) has RMB1,810mn outstanding contract backlog, jumped 86% yoy. It is expected that 70% of backlog will be converted into income in FY14, mainly contributed by intelligent electrical distribution (iEDS, 68%), followed by spare parts and components (CSP, 16%), the remainder being energy efficient solutions (EES, 14%). Based on the strong backlog on hands, and the track record of completion, we are confident that the aggressive management guidance is achievable, which raised from its prudent 20% to 30%-40% earnings growth in FY14E.

**Exhibit 65: Increasing Backlog**



Source: Company, OP Research

**Exhibit 66: Component of Backlog as at the end of FY13 (RMB/mn)**



Source: Company, OP Research

## Ambition in smart home

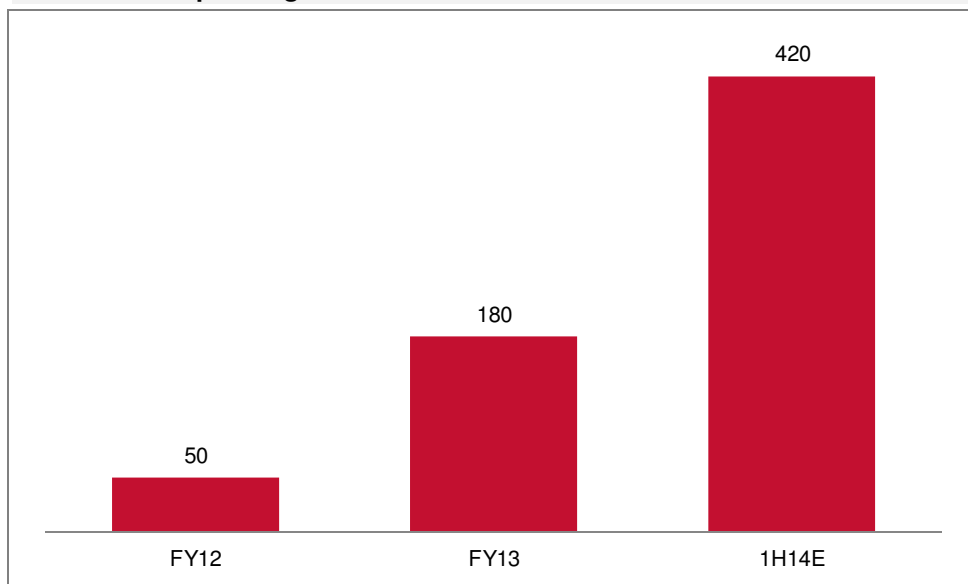
### Roadshow started with expand sales network drive CSP growth

Boer Power (BP) has set up a separate distribution network for smart home products, with about 80 distributors nationwide, the first product 'Home Care Unveiled'(家衛士) started to be promoted in April 2014, it is constituted by a network and main computer which could monitor and control home security, electrical appliances, switches, temperature via software in remote mobile device. According to Beijing Govmade Information Consultants, the smart home industry will enjoy CAGR 20% in FY10-15E, reach RMB1,380mn at the end of FY15E.

In fact, international technology brands such as Google, Apple, and domestic brands such as Tencent (700 HK), Sina, MI have also venture into the industry, signaling the industry is entering into a rapid growth phase. . We believe the expansion in sales network most likely support the launch of smart home products, we believe the sales in spare parts and components (CSP) segment will be boosted along with margin improvement

**Blue ocean in 'Smart Home' kicked off by technology giants**

**Exhibit 67: Expanding sales network**



Source: Company, OP Research

## Riding on energy management of data center

### Renowned customer base on data centre

Boer Power utilizing its customer base in power distribution, target on Data Centre and medical device market, current customers includes Centrin Data Systems, Global Data Solution, China Mobile and China Unicom, which is leading cloud computing operations service provider or telecom giant.

It is estimated that data center industry is growing at CAGR 10% in FY13-15E, driven by popularity of data usage, the penetration of energy efficient solution is still low, the China government has addressed a special concern on renovation of cooling system, which consumed 45% of total energy consumption. According to IDCUN, over-cooling problem exists in more than 85% of data centers. We believe the rising concern on energy savings in data center will benefit the growth in energy efficiency of BP.

Together with the stable development in medical services Industry, we believe EE segment could enjoy a moderate growth of 10% yoy in FY14E, based on a lower proportion in FY13 year-end backlog.

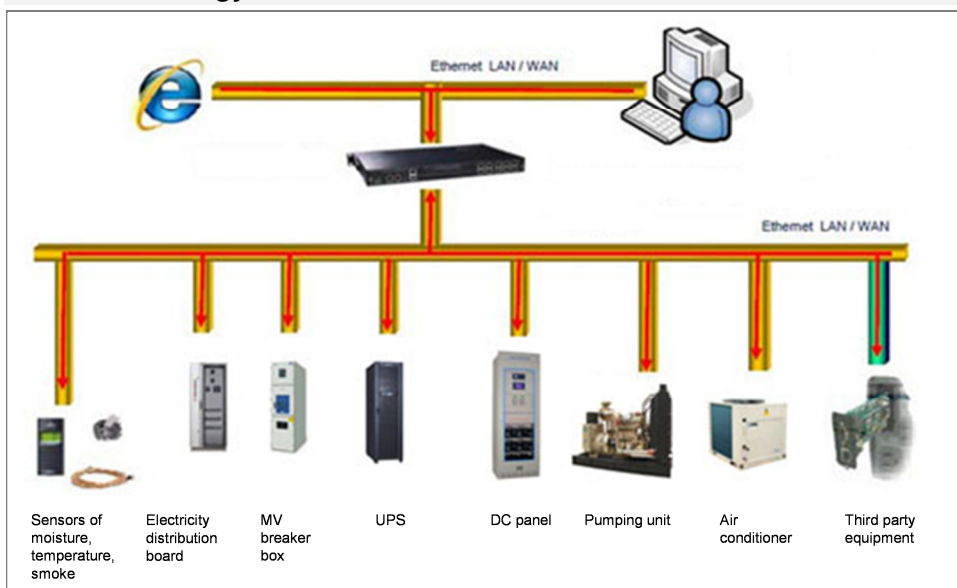
**Demand in energy efficiency in Data center has been a growth driver but may slow down**

**Exhibit 68: Data center customer**



Source: Company, OP Research

**Exhibit 69: Energy efficient solution in data center**



Source: Company, OP Research



## Initiate BUY on strong backlog & new products

**Boost in turnover outweighs squeezing margin:** The strong backlog is an indication of high growth in FY14E, we believe it is partly due to the expansion of distribution network from 50 to 180 in FY13, with a faster expansion pace in 1H14E, we expect the growth will continue. We believe the major growth driver will shift from Energy Efficiency Solution (EE) to intelligent Electrical Distribution Solution (iEDS) due to introduction of solid-insulated Ring Main Unit (RMU). However, we expect gross margin of iEDS and EE is likely to be squeezed when awareness increases and more competitors enter, gross margin of CSP is estimated to be bound due to expansion of customer base into residential which have lower buyers bargaining power. Net net, we believe the operating margin will be lower due to increase in sales expense, we see it is a trade-off between margin expansion and turnover expansion.

**Introduction of solid insulated RMU eases the pressure of iEDS.** The current market capacity of RMU is 580k units, 64% gas-insulated, 32% air-insulated, 4% solid-insulated. Solid-insulated RMU is listed as highlight technology by SGCC, according to solid-insulated RMU Council, the demand of RMU in 2015E is estimated at 300k units, in which solid-insulated RMU reach 75k units, market size reach RMB5bn, and penetration reach 30% in 2018. Boer Power is one of the few producers of the product, we believe they are able to capture the trend and boost turnover in iEDS.

**Acquisition of Temper (a Spanish company) gives hope of overseas development:** BP purchased Group De Empresas Temper (a Spanish company) on 2013 May for EUR 250k, at the same time the Group also restructured the Oversea Sales Department in preparation for the South America and Asia Pacific markets. Though the contribution of revenue is less than 1% currently, it is a milestone for the strategic overseas development, and worth pay attention to future development.

**Initiate BUY with TP HK\$10.8:** We initiate our BUY rating on Boer Power with TP HK\$10.8 based on 15x FY14E PE, implies 14% upside. The target PE is discount to its international leaders, such as Schneider (SU FP Equity) and ABB (ABBN VX Equity).

## Key Risks

### **Uncertainty in completion of backlogs**

Our forecast is based on backlogs on hand at the end of FY13, we expect 70% could be completed in FY14E, any delay in completion will impact negatively the turnover.

### **Market acceptance of smart home products**

'Smart Home' products are venture market, sales volume does not only depend on the ability of distribution network, but also the acceptance of market, we expect it will be reflected in 2H14E.

### **Slowdown in energy efficient solution faster than expected**

The customers in energy efficient solution are mainly data center and medical equipment, slowdown in demand of energy efficient solution in either industry will harm top-line growth.

### **Competition arises in power distribution**

We expect the manufacturers in metering and power distribution will step into power distribution solution providers, competition may squeeze gross margin.

## Appendix I – Key Management Profiles

**Mr. Qian Yixiang (錢毅湘), Chairman/CEO:** Aged 40, Mr. Qian primarily responsible for the overall management and strategic development of the Group. He joined Wuxi Boer Power Instrumentation Company Ltd. ( “Wuxi Boer” ), the predecessor entity of the Group, in July 1995 and became the General Manager of Wuxi Boer in January 1998. Since he first joined Wuxi Boer in July 1995, Mr. Qian Yixiang has acquired knowledge and experience about the electrical distribution systems and the electrical distribution equipment industry. Mr. Qian Yixiang graduated from Jiangnan University with a Diploma in Business Management in 1995.

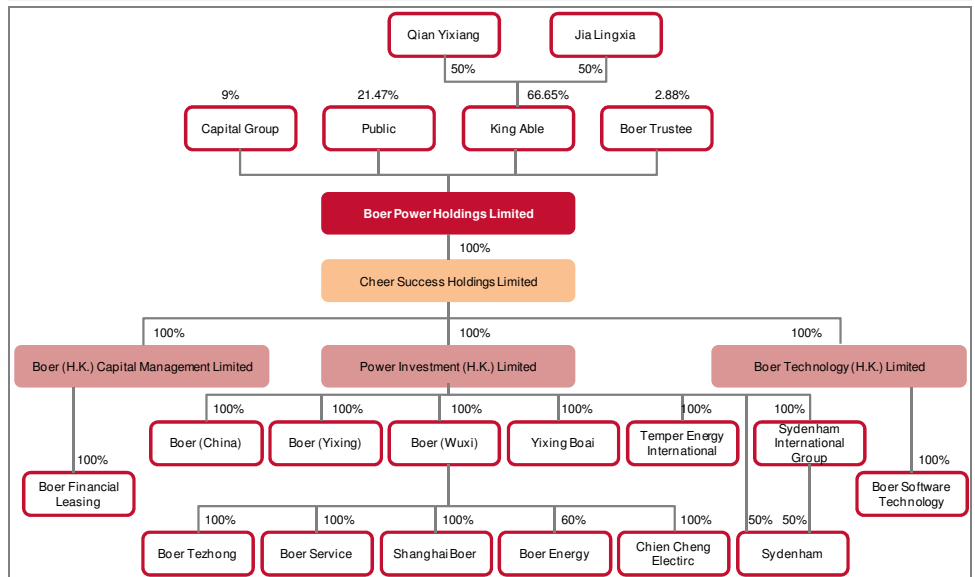
**Ms. Jia Lingxia (賈凌霞), COO:** Aged 40, Ms. Jia is primarily responsible for the overall management of the daily operations of the Group. Ms. Jia joined Wuxi Boer in August 1995 and became the Deputy General Manager of Wuxi Boer in January 1997. From February 1995 to August 1995, Ms. Jia worked at Wuxi Special Ventilation Machine Factory, currently known as Wuxi Xishan Special Ventilation Machine Factory, as the head of the accounts department. Since Ms. Jia joined Wuxi Boer in August 1995, she has acquired knowledge and experience about the electrical distribution systems and the electrical distribution equipment industry. Ms. Jia graduated from Jiangnan University with a Diploma in Business Management in 1995. Ms. Jia is the wife of Mr. Qian Yixiang (Chairman).

**Mr. Zha Saibin (查賽杉), Vice President:** Aged 47, is responsible for new products development. Mr. Zha joined Wuxi Boer in June 2000 and became the Assistant Manager and the head of research and development department of Wuxi Boer in 2003. Prior to joining the Group, Mr. Zha worked at Wuxi City Apparatus Factory from July 1990 to May 2000 and was later appointed as the head of research and development and the Deputy General Manager in January 1996 and November 1997, respectively. Since joining Wuxi Boer in June 2000, Mr. Zha has acquired knowledge and experience about the electrical distribution systems and the electrical distribution equipment industry. Mr. Zha received a Bachelor’s degree in Engineering in 1990 from Hefei University of Technology.

**Mr. Huang Liang (黃亮), CFO:** Aged 40, Mr. Huang has over 20 years of experience in accounting and finance. Mr. Huang joined Boer Wuxi in January 2009 as the Financial Manager. Prior to joining the Group, Mr. Huang worked as the head of the finance department of Wuxi Second Boarding House from October 1991 to May 2001 and as the Assistant Manager of Wuxi Zhengzhuo CPAs Ltd., currently known as Jiangsu Zhengzhuo Hengxin CPAs Ltd., from June 2001 to December 2008. Mr. Huang graduated from Shanghai University of Finance and Economics with a Diploma in Accounting in 1996.

## Appendix II – Shareholding Structure

Exhibit 70: Shareholding Structure



Source : Company, OP Research

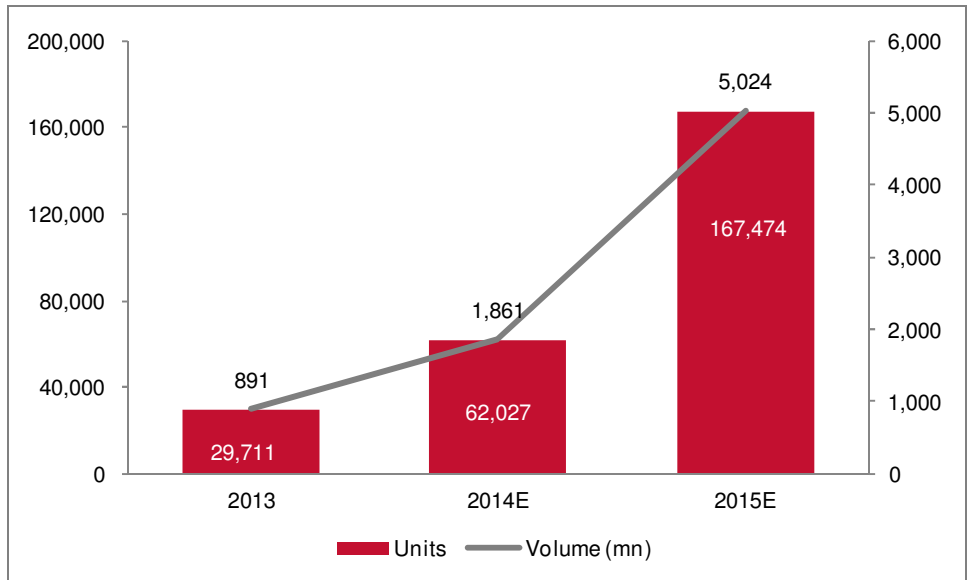
## Appendix III – Key Products

**Exhibit 71: XGreen solid insulated RMU**



Source : Company, OP Research

**Exhibit 72: RMU demand from SGCC**



Source: Company, OP Research

## Financial Summary – Boer Power (1685HK)

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Income Statement (RMB mn)</b>					
EDS solution	20	10	10	10	10
iEDS solution	845	915	1,235	1,457	1,573
EE solution	151	236	260	286	315
CSP Business	205	193	361	469	563
<b>Turnover</b>	<b>1,221</b>	<b>1,354</b>	<b>1,866</b>	<b>2,222</b>	<b>2,461</b>
YoY%	20	11	38	19	11
COGS	(771)	(867)	(1,211)	(1,447)	(1,604)
<b>Gross profit</b>	<b>450</b>	<b>487</b>	<b>655</b>	<b>776</b>	<b>857</b>
Gross margin	36.8%	36.0%	35.1%	34.9%	34.8%
Other income	10	75	75	75	75
Selling & distribution	(46)	(54)	(58)	(60)	(62)
Admin	(16)	(48)	(68)	(78)	(89)
R&D	(41)	(33)	(45)	(54)	(60)
Other opex	(53)	(66)	(91)	(109)	(121)
<b>Total opex</b>	<b>(156)</b>	<b>(201)</b>	<b>(263)</b>	<b>(301)</b>	<b>(331)</b>
<b>Operating profit (EBIT)</b>	<b>303</b>	<b>362</b>	<b>468</b>	<b>550</b>	<b>602</b>
Operating margin	24.8%	26.7%	25.1%	24.8%	24.4%
Provisions	0	0	0	0	0
Interest Income	21	8	16	23	35
Finance costs	(0)	(8)	(16)	(16)	(16)
Profit after financing costs	324	362	469	558	621
Associated companies & JVs	0	0	0	0	0
Pre-tax profit	324	362	469	558	621
Tax	(30)	(17)	(22)	(26)	(29)
Minority interests	0	0	0	0	0
<b>Net profit</b>	<b>293</b>	<b>345</b>	<b>447</b>	<b>532</b>	<b>591</b>
YoY%	16	18	30	19	11
Net margin	24.0%	25.5%	23.9%	23.9%	24.0%
<b>EBITDA</b>	<b>325</b>	<b>387</b>	<b>506</b>	<b>593</b>	<b>653</b>
EBITDA margin	26.6%	28.6%	27.1%	26.7%	26.5%
<b>EPS (RMB)</b>	<b>0.384</b>	<b>0.456</b>	<b>0.575</b>	<b>0.685</b>	<b>0.762</b>
YoY%	17	19	26	19	11
DPS (HK\$)	0.120	0.310	0.180	0.214	0.238
<b>Cash Flow (RMB mn)</b>					
EBITDA	325	387	506	593	653
Chg in working cap	63	185	(75)	(45)	53
Others	(3)	27	0	0	0
<b>Operating cash</b>	<b>384</b>	<b>598</b>	<b>430</b>	<b>548</b>	<b>706</b>
Interests paid	0	0	16	23	35
Tax	(36)	(49)	(7)	(22)	(26)
<b>Net cash from operations</b>	<b>348</b>	<b>549</b>	<b>440</b>	<b>549</b>	<b>714</b>
Capex	(14)	(10)	(14)	(16)	(18)
Investments	(242)	(414)	(25)	(30)	(33)
Dividends received	(10)	(1)	0	0	0
Sales of assets	0	0	0	0	0
Interests received	8	17	0	0	0
Others	(255)	45	(16)	(16)	(16)
<b>Investing cash</b>	<b>(513)</b>	<b>(362)</b>	<b>(54)</b>	<b>(61)</b>	<b>(66)</b>
<b>FCF</b>	<b>(165)</b>	<b>186</b>	<b>386</b>	<b>488</b>	<b>648</b>
Issue of shares	(2)	(70)	0	0	0
Buy-back	0	0	0	0	0
Minority interests	0	4	0	0	0
Dividends paid	(63)	(72)	(183)	(112)	(133)
Net change in bank loans	(38)	434	0	0	0
Others	(0)	(5)	0	0	0
<b>Financing cash</b>	<b>(103)</b>	<b>291</b>	<b>(183)</b>	<b>(112)</b>	<b>(133)</b>
<b>Net change in cash</b>	<b>(268)</b>	<b>478</b>	<b>203</b>	<b>376</b>	<b>515</b>
Exchange rate or other Adj	(3)	(8)	0	0	0
Opening cash	653	382	852	1,055	1,431
<b>Closing cash</b>	<b>382</b>	<b>852</b>	<b>1,055</b>	<b>1,431</b>	<b>1,945</b>
<b>CFPS (HK\$)</b>	<b>0.569</b>	<b>0.907</b>	<b>0.708</b>	<b>0.884</b>	<b>1.149</b>

Source: Company, OP Research

Year to Dec	FY12A	FY13A	FY14E	FY15E	FY16E
<b>Ratios</b>					
Gross margin (%)	36.8	36.0	35.1	34.9	34.8
Operating margin (%)	24.8	26.7	25.1	24.8	24.4
Net margin (%)	24.0	25.5	23.9	23.9	24.0
Selling & dist'n exp/Sales (%)	3.8	4.0	3.1	2.7	2.5
Admin exp/Sales (%)	1.3	3.5	3.7	3.5	3.6
Payout ratio (%)	25.0	54.4	25.0	25.0	25.0
Effective tax (%)	9.4	4.7	4.7	4.7	4.7
Total debt/equity (%)	0.0	21.9	19.3	16.3	13.9
Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	3.2	2.3	2.2	2.3	2.4
Quick ratio (x)	3.1	2.3	2.1	2.2	2.3
Inventory T/O (days)	35	29	29	29	29
AR T/O (days)	329	296	290	285	270
AP T/O (days)	302	347	350	350	350
Cash conversion cycle (days)	62	(22)	(31)	(36)	(51)
Asset turnover (x)	0.6	0.5	0.5	0.5	0.5
Financial leverage (x)	1.4	1.5	1.7	1.7	1.7
EBIT margin (%)	24.8	26.7	25.1	24.8	24.4
Interest burden (x)	1.1	1.0	1.0	1.0	1.0
Tax burden (x)	0.9	1.0	1.0	1.0	1.0
<b>Return on equity (%)</b>	<b>18.1</b>	<b>18.7</b>	<b>21.4</b>	<b>21.9</b>	<b>20.6</b>
<b>ROIC (%)</b>	<b>24.7</b>	<b>25.1</b>	<b>30.9</b>	<b>35.0</b>	<b>38.4</b>
<b>Balance Sheet (RMB mn)</b>					
Fixed assets	227	212	204	198	191
Intangible assets & goodwill	79	84	93	102	108
Associated companies & JVs	0	0	0	0	0
Long-term investments	6	4	4	4	4
Other non-current assets	3	5	5	5	5
<b>Non-current assets</b>	<b>315</b>	<b>305</b>	<b>306</b>	<b>308</b>	<b>308</b>
Inventories	74	69	96	115	128
AR	1,102	1,098	1,482	1,735	1,821
Prepayments & deposits	0	0	0	0	0
Other current assets	522	902	902	902	902
Cash	382	852	1,055	1,431	1,945
<b>Current assets</b>	<b>2,079</b>	<b>2,921</b>	<b>3,536</b>	<b>4,183</b>	<b>4,796</b>
AP	638	824	1,161	1,387	1,538
Tax	12	7	22	26	29
Accruals & other payables	0	0	0	0	0
Bank loans & leases	0	430	430	430	430
CB & othe debts	0	0	0	0	0
Other current liabilities	0	0	0	0	0
<b>Current liabilities</b>	<b>650</b>	<b>1,260</b>	<b>1,612</b>	<b>1,843</b>	<b>1,997</b>
Bank loans & leases	0	0	0	0	0
CB & othe debts	0	0	0	0	0
Deferred tax & others	6	3	3	3	3
MI	0	4	4	4	4
<b>Non-current liabilities</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>
<b>Total net assets</b>	<b>1,738</b>	<b>1,959</b>	<b>2,223</b>	<b>2,643</b>	<b>3,101</b>
<b>Shareholder's equity</b>	<b>1,738</b>	<b>1,959</b>	<b>2,223</b>	<b>2,643</b>	<b>3,101</b>
Share capital	66	66	66	66	66
Reserves	1,671	1,893	2,156	2,576	3,035
<b>BVPS (HK\$)</b>	<b>2.84</b>	<b>3.24</b>	<b>3.58</b>	<b>4.25</b>	<b>4.99</b>
Total debts	0	430	430	430	430
Net cash/(debts)	409	550	753	1,130	1,644

**Exhibit 73: Peer Group Comparison**

Company	Ticker	Price	Mkt cap (US\$m)	3-mth		PER FY2	EPS FY1	EPS FY2	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	EV/ Hist	EV/ Cur Yr	Gross		Net		ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
				avg t/o (US\$m)	PER Hist (x)												Net margin Hist (%)	margin (%)						
<b>Boer Power Holdi</b>	<b>1685 HK</b>	<b>9.45</b>	<b>941</b>	<b>0.5</b>	<b>19.0</b>	<b>15.6</b>	<b>12.6</b>	<b>22.1</b>	<b>23.1</b>	<b>18.1</b>	<b>0.86</b>	<b>2.9</b>	<b>1.6</b>	<b>3.34</b>	<b>3.04</b>	<b>19.7</b>	<b>13.1</b>	<b>Net cash</b>	<b>36.0</b>	<b>25.5</b>	<b>18.7</b>	<b>20.6</b>	<b>7.5</b>	<b>13.2</b>
HSI		24,756.85			11.1	11.6	10.7	(4.4)	8.7	4.4	2.64	3.6	3.4	1.46	1.39						13.2	12.0	7.1	10.7
HSCEI		11,130.20			8.2	7.7	7.0	6.2	9.0	8.1	0.95	3.9	4.2	1.24	1.14						15.2	14.8	6.3	11.9
CSI300		2,350.25			10.8	9.5	8.3	13.4	15.1	14.4	0.66	2.5	2.8	1.55	1.39						14.3	14.7	9.7	12.3
<b>Adjusted sector avg*</b>					<b>20.3</b>	<b>17.0</b>	<b>15.0</b>	<b>18.6</b>	<b>18.6</b>	<b>15.2</b>	<b>0.97</b>	<b>2.1</b>	<b>2.5</b>	<b>2.87</b>	<b>2.90</b>	<b>13.1</b>	<b>10.1</b>	<b>9.1</b>	<b>31.0</b>	<b>7.2</b>	<b>14.9</b>	<b>17.4</b>	<b>(0.0)</b>	<b>6.1</b>
Wasion Group Hol	3393 HK	6.18	754	1.1	11.9	10.6	8.9	13.0	18.5	15.6	0.68	3.2	3.8	1.67	1.53	10.2	8.4	2.6	35.1	16.6	14.7	15.0	11.7	14.3
Nari Technolog-A	600406 CH	15.40	6,132	54.3	22.1	17.5	13.7	25.9	28.4	27.0	0.65	0.7	1.0	5.66	4.49	22.0	16.4	0.0	26.4	16.9	32.8	24.9	2.2	13.0
Xj Electric-A	000400 CH	22.99	3,800	48.5	30.3	17.9	13.4	69.2	33.7	33.6	0.53	0.3	1.3	4.42	3.84	23.9	13.9	0.0	26.2	7.4	16.7	17.6	(1.0)	19.3
Beijing Creat-A	002350 CH	11.06	396	3.7	42.1	24.5	18.7	71.4	31.3	N/A	N/A	0.5	N/A	2.52	N/A	27.3	N/A	0.0	29.0	6.2	6.2	N/A	10.1	21.4
Abb Ltd-Reg	ABBN VX	20.98		115.9	18.7	17.2	14.9	8.4	15.6	11.7	1.47	3.4	3.5	2.92	2.68	9.7	9.8	8.0	28.7	6.7	14.9	15.4	0.5	(2.6)
Schneider Electr	SU FP	63.22	36,893	75.4	18.5	16.7	14.3	10.9	16.2	12.8	1.30	2.9	3.0	2.02	1.93	10.7	11.2	19.2	37.8	8.0	10.9	12.1	(5.7)	(5.9)
Siemens Ag-Reg	SIE GR	92.11	81,149	141.6	18.3	14.1	12.6	30.0	12.1	16.7	0.85	3.2	3.5	2.78	2.60	11.8	9.8	42.5	27.4	5.6	17.8	18.6	0.5	(3.0)
Emerson Elec Co	EMR US	63.21	44,666	191.5	23.0	17.2	15.5	33.6	11.0	17.7	0.97	2.7	2.7	4.12	4.14	9.4	9.8	22.1	40.3	8.1	24.2	24.3	(5.3)	(4.4)
Mitsub Elec Corp	6503 JP	1,376.00	2,954,549	73.7	18.5	15.5	14.1	19.9	9.3	11.9	1.30	1.3	1.4	1.84	1.71	7.6	6.4	0.0	28.1	3.8	11.9	11.6	2.0	19.1
Legrand Sa	LR FP	41.41	11,018	19.0	21.0	19.6	17.9	6.9	9.9	8.5	2.32	2.5	2.6	3.51	3.19	12.2	12.0	29.8	51.7	11.9	16.9	16.9	(3.6)	(10.5)

\* Outliners and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

## Appendix – Terminology

### Exhibit 74: Terminology in smart grid

Term	Abbreviation	Meaning
3-phase ac power system		Commercial use in alternative current power system
Advance metering infrastructure	AMI	A system to collect power consumption data, including smart home control panel, smart meters, data collection terminals, communication system between terminal and substation, meter data management by software analysis
Advanced distribution operations	ADO	A system to decide allocation of power, including smart meters, distribution unit like ring main unit which consist of circuits, circuit breakers and transformers, automated distribution terminal that collect and analyze data from smart meters and distribution unit
Energy management	EM	A mechanical engineering or power distribution solution that restructure power distribution system or air-conditioning network, including light, air conditioning, computers, lift, gathered and analyzed consumption data from smart meters, sensors, thermostat, automatically adjust power distribution to maximize user's satisfaction with minimum power usage
Energy management contract	EMC	Suppliers sign a long-years term contract with customer, payment depends on the amount of energy saved by the suppliers
Energy solution		A mechanical engineering or power distribution solution that restructure power distribution system or air-conditioning network, including light, air conditioning, computers, lift, gathered and analyzed consumption data from smart meters, sensors, thermostat, automatically adjust power distribution to maximize user's satisfaction with minimum power usage
Extra high voltage	EHV	Copper-based power cables, used in underground regional power distribution that connect substation and buildings
Power disruption positioning system		Enables grid operator identifies the position of power disruption and rerouted so the disturbance will be limited in a small area of neighborhood only.
Power distribution solution		A circuit network gathering small circuits to distribute power from power source to user, usually by ring main unit, switchgears, transformers
Smart home components		Network that connect home electrical appliances, with a terminal that could analyze power usage and control on/off remotely, or react automatically to suit user's satisfaction, basically include cameras, TV, air-conditioning, sensor of heat, light, switches
Smart meters		Electronic meters with network that could send data to remote user, usually utility company
Ultra high voltage	UHV	Aluminum-based power wires, used in overhead long distance power transmission
Intelligent electrical distribution solution	iEDS	A circuit network that gather and analyze power usage, with remote control feature
3-phase ac power system		Commercial use in alternative current power system
Advance metering infrastructure	AMI	A system to collect power consumption data, including smart home control panel, smart meters, data collection terminals, communication system between terminals and substation, meter data management by software analysis

Source: Company, OP Research



## Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
31/07/2014	China Fiber Optic Network	3777	Upgrade on margin expansion kick-off	BUY	Yuji Fung
25/07/2014	SCUD Group	1399	Sell-off unwarranted	BUY	Vivien Chan
21/07/2014	Beijing Properties	925	A step forward in cold chain logistics network	BUY	Bruce Yeung
17/07/2014	Sinotrans	598	New shares placement by a cash rich company	BUY	Bruce Yeung
15/07/2014	Geely Auto	175	Coming out of the tunnel	BUY	Vivien Chan
11/07/2014	Beijing Properties	925	Introducing Strategic Investors for Logistics Facilities Development	BUY	Bruce Yeung
11/07/2014	Logistic sector	-	E-commerce Enablers in China	BUY	Bruce Yeung
30/06/2014	Tiangong	826	Entry point appeared	BUY	Vivien Chan
27/06/2014	SCUD Group	1399	Mipad Boosts Battery Sales	BUY	Vivien Chan
26/06/2014	Technovator	1206	Buy the dips	BUY	Lily Man/ Yuji Fung
23/06/2014	SCUD Group	1399	Juice Up Your Smartphone	BUY	Vivien Chan
10/06/2014	Great Wall Motor	2333	Sedan sales remain weak	HOLD	Vivien Chan
20/05/2014	Brilliance China	1114	Still a brilliant story	BUY	Vivien Chan
12/05/2014	HC International	8292	Solid start of 2014 for 75% profit growth	BUY	Yuji Fung
09/05/2014	Great Wall Motor	2333	Confidence collapsed	HOLD	Vivien Chan
09/05/2014	TCL COMM	2618	Apr smartphone shipments up 11%mom	BUY	Yuji Fung
07/05/2014	China Fiber Optic Network	3777	1Q14 sales up 21%, better than we expect	BUY	Yuji Fung
07/05/2014	Great Wall Motor	2333	Looking forward, not backward	BUY	Vivien Chan
25/04/2014	TCL Multimedia	1070	Gloomy 2014	HOLD	Yuji Fung
25/04/2014	TCL COMM	2618	Upgrade on new sales growth target	BUY	Yuji Fung
23/04/2014	HC International	8292	1Q14 positive profit alert	BUY	Yuji Fung
22/04/2014	Technovator	1206	Asset injection kicks off	BUY	Yuji Fung
07/04/2014	China All Access	633	FY13 core earnings slump	HOLD	Yuji Fung/ Cindy Li
03/04/2014	China Fiber Optic Network	3777	Strategic cooperation with FiberHome	BUY	Yuji Fung
28/03/2014	Chinasoft Int'l	354	Still not the right time	HOLD	Yuji Fung/ Cindy Li
28/03/2014	Xiangyu Dredging	871	FY13 Results First-take	BUY	Min Li/ Jose Xu
28/03/2014	Tiangong	826	Re-rate catalyst remains	BUY	Vivien Chan

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