



August 13, 2014
Company Report
Rating: BUY
TP: HK\$ 32.52

H-Share price (HK\$)	27.55
Est. share price return	18.04%
Est. dividend yield	2.08%
Est. total return	20.12%

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Key Data

52Wk H/L(HK\$)	30.20 / 20.45
Issued shares (mn)	1,175
H-Shares (mn)	547
Domestic Shares (mn)	628
Market cap	
H-shares (HK\$ mn)	15,070
Domestic Shares (HK\$ mn)	17,301
3-mth avg daily turnover (HK\$ mn)	68.0
Major shareholder(s) (%):	
CSR (1766 HK)	51.81

Source(s): Company, Bloomberg, ABCI Securities

1H 14 Revenue breakdowns (%)

Train-borne electrical systems	
Locomotive	13.90
MUs	54.95
Metro	9.79
Others electrical systems	14.35
Electric components and others	7.01

Source(s): Company, ABCI Securities

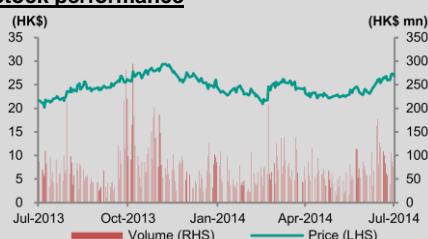
Share performance (%)

	Absolute	Relative*
1-mth	3.96	(1.69)
3-mth	18.49	9.09
6-mth	14.32	3.19

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

ZCSR (3898 HK)
Upgrade to BUY on inspiring 1H14 results and forthcoming MUs procurement

- Thanks to the strong delivery of MUs equipment, revenue and net income doubled to RMB 5,150mn and RMB 857mn in 1H14
- Higher revenue that reduced fixed cost per unit enabled net margin to improve by 1.3ppt YoY to 16.6% in 1H14
- We expect the CRC would soon start procuring MU and this would elevate ZCSR's sales in 2H14 and 1H15
- We revise up our FY14E/15E earnings forecasts of ZCSR. Our new TP of HK\$ 32.52 is based on 17x of FY14E EPS, equivalent to the upper quartile of its historical P/E since 2011. The counter is currently trading at 14.4x FY14E P/E. We believe the valuation is undemanding and upgrade ZCSR from hold to **BUY**

Inspiring 1H14 results. Thanks to recovering procurement by China Railway Corporation (CRC), the Group's revenue (excluding business taxes and surcharges) rebounded by 97.85% YoY to RMB 5,150mn in 1H14. Segment revenue from MU equipment was up about 8 times YoY, rising from RMB 313mn in 1H13 to RMB 2,830mn in 1H14. Net income surged by 114.25% YoY to RMB 857mn in 1H14. Separately, these inspiring results from ZCSR, an upstream supplier of rolling stock equipment, reconfirm that strong delivery can be expected for CSR (1766 HK) in 2H14.

Profit margin improved. Although GPM dropped by 2ppt YoY to 35.5% in 1H14 due to changes in product mix, the higher revenue, which helped lower the fixed cost per unit, boosted net margin by 1.3ppt YoY to 16.6% in 1H14. SG&A cost-to-revenue ratio dropped 4.2ppt YoY from 19.1% in 1H13 to 14.9% in 1H14.

CRC's procurement – a key growth driver. As CRC's budgeted CAPEX for 2014 increased from RMB 600bn to RMB 800bn, we expect the investment in rolling stock to increase, and tendering for MUs would soon commence. The upcoming MUs tender, which comprises ~300 sets of MUs with a total value of RMB 60bn, will trigger demands for electrical components, hence benefiting ZCSR's sales in 2H14 and 1H15.

Upgrade to BUY. Looking forward, we expect strong demand for electrical components for rolling stock, as driven by the completion of new railway lines and development of urban rails in the major cities, will shore up the Group's profits. We revise up our earnings projections for 2014E-15E by 26.1% and 24.1% on CRC's increased CAPEX budget. Our TP of HK\$ 32.52 (previous TP: HK\$ 27.72) is equivalent to 17x of FY14E EPS, representing the median of ZCSR's historical P/E since 2011. We expect CRC would announce tender for MU soon. With this positive catalyst, we therefore upgrade ZCSR from hold to BUY.

Risk factors: 1) 2H14 net income growth YoY may be slower than in 1H14 due to high-base effect; 2) CRC may delay MU procurement and ZCSR's earnings growth could be slowed as a result.

Results and Valuation

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	7,186	8,781	10,263	11,330	12,235
Chg (% YoY)		22.20	16.88	10.39	7.99
Net Income (RMB mn)	1,224	1,467	1,806	2,015	2,127
Chg (% YoY)		19.85	23.11	11.58	5.57
FD EPS (RMB)	1.129	1.248	1.536	1.714	1.810
P/E (x)	-	-	14.40	12.91	12.23
BVPS (RMB)	5.703	7.670	8.875	10.129	11.424
P/B (x)	-	-	2.49	2.18	1.94
DPS (RMB)	0.350	0.350	0.461	0.514	0.543
Yield (%)	-	-	2.08	2.32	2.45
ROAE (%)	21.29	19.30	18.57	18.04	16.79
Net gearing (%)		Net Cash	Net Cash	Net Cash	Net Cash

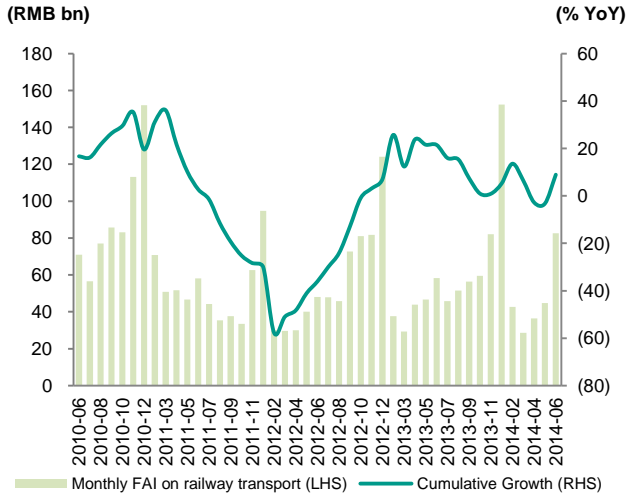
* Net gearing=Net debt/Total equity

Source(s): Bloomberg, ABCI Securities estimates

Railway transport investment to increase

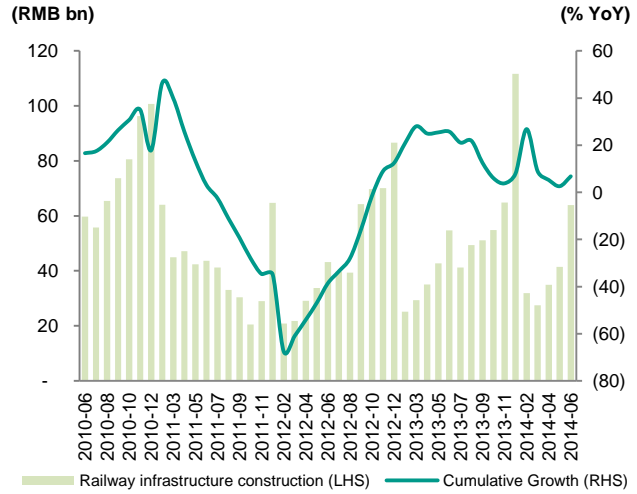
CRC's CAPEX is budgeted at RMB 800bn for 2014. We believe railway investment would grow by 20.1% YoY for the full year. Since total railway infrastructure investment and CRC's CAPEX for 1H14 were up only by 6.77% YoY and 8.92% YoY, railway investment would escalate in 2H14. We believe CRC will likely procure MUs soon, supporting sales in ZCSR in 2H14/2015.

Exhibit 1: Monthly fixed-asset investment by CRC and YTD growth in 1H10-1H14



Source(s): China Railway Corporation, ABCI Securities

Exhibit 2: Monthly infrastructure investment by CRC and YTD growth in 1H10-1H14

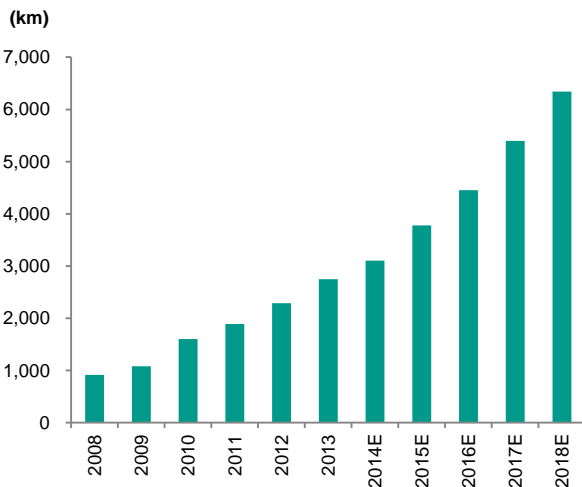


Source(s): China Railway Corporation, ABCI Securities

Development of urban rail in China

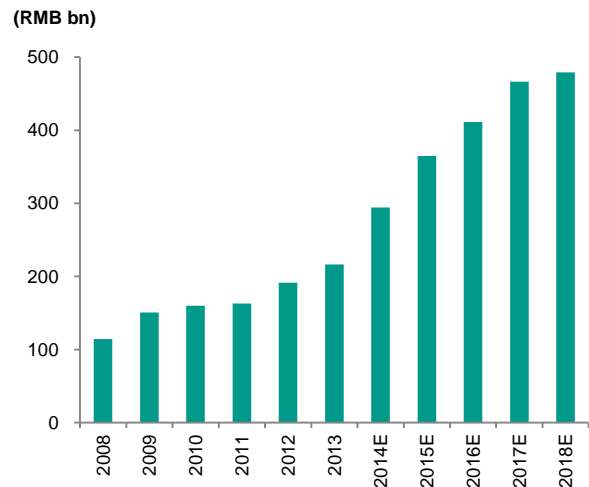
Based on the construction pipeline in the tier 1/2 cities, growth in urban rail industry is expected to continue in the next few years. According to CCID Consulting, investment on urban rail development is estimated to grow at 17.22% CAGR over 2013-18E. Strong growth in urban rail is expected to spur demand for metro compartments and corresponding electrical systems, benefiting ZCSR in the mid-to-long run.

Exhibit 3: Operation length of the urban rail transit in China (2008-2018E)



Source(s): China Association of Metros, CCID Consulting, ABCI Securities

Exhibit 4: Investment on urban rail transit in China (2008-2018E)



Source(s): China Association of Metros, CCID Consulting, ABCI Securities



Exhibit 5: Financial summary of ZCSR in 1H12-1H14

(RMB mn)	1H12	2H12	1H13	2H13	1H14	(% YoY)
Reported revenue	3,200	4,049	2,624	6,232	5,180	97.41
Less: Business taxes & surcharges	26	37	21	54	30	42.86
Adjusted revenue	3,174	4,012	2,603	6,178	5,150	97.85
Less: Operating cost	2,070	2,733	1,628	4,067	3,324	104.18
Gross Profit	1,104	1,279	975	2,111	1,826	87.28
GPM (%)	34.78	31.88	37.46	34.17	35.46	(2.00ppt)
Selling and distribution cost	143	191	131	367	275	109.92
Administrative cost	434	429	366	639	494	34.97
SG&A (RMB mn)	577	620	497	1,006	769	54.73
SG&A-to-revenue (%)	18.18	15.45	19.09	16.28	14.93	(4.16ppt)
Net profit (ex. MI)	546	678	400	1,067	857	114.25
Net profit margin (%)	17.20	16.90	15.37	17.27	16.64	1.27ppt
Total debt	28	69	66	83	60	(9.09)
Less: Total cash and equivalents	1,341	2,319	1,583	3,136	2,729	72.39
Net debt (cash)	(1,313)	(2,250)	(1,517)	(3,053)	(2,669)	N/A
Total equity	5,618	6,319	6,307	9,150	9,656	53.10
Net gearing (%)	(23.37)	(35.61)	(24.05)	(33.37)	(27.64)	(3.59ppt)

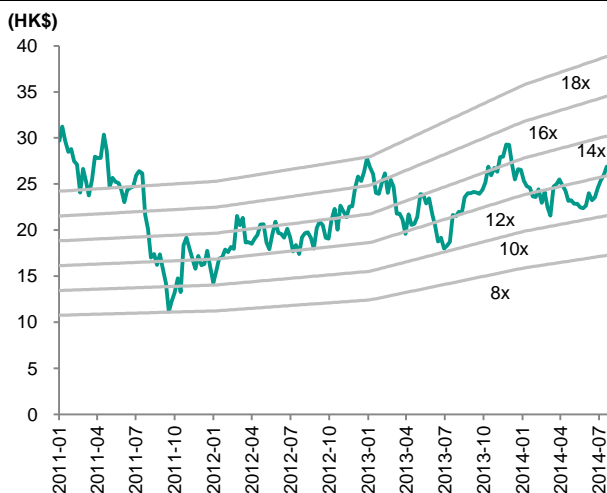
Source(s): Company, ABCI Securities

Exhibit 6: FY14E-15E financial projections for ZCSR

	FY14E			FY15E		
	Previous	New	Chg (%)	Previous	New	Chg (%)
Revenue (RMB mn)	8,745	10,263	17.36	10,048	11,330	12.76
Gross profit (RMB mn)	2,929	3,601	22.95	3,330	4,052	21.69
GPM (%)	33.49	35.09	1.59ppts	33.14	35.77	2.63ppts
Net income (RMB mn)	1,432	1,806	26.12	1,623	2,015	24.16
Net margin (%)	16.38	17.60	1.22ppts	16.15	17.79	1.63ppts
EPS (RMB)	1.218	1.536	26.14	1.381	1.714	24.14
BVPS (RMB)	8.444	8.875	5.11	9.460	10.129	7.07
DPS (RMB)	0.365	0.461	26.28	0.414	0.514	24.23

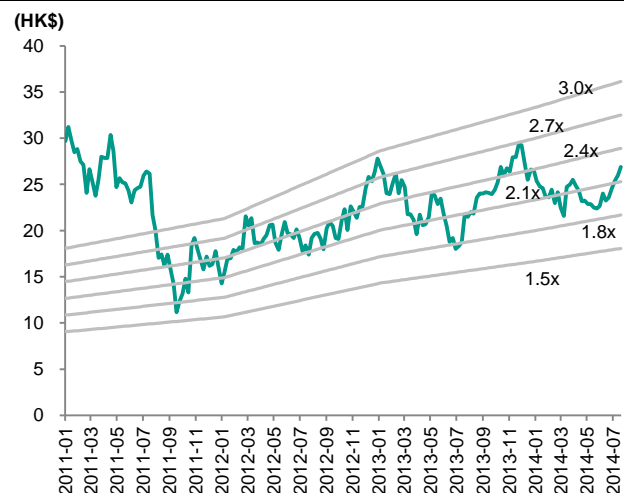
Source(s): ABCI Securities estimates

Exhibit 7: P/E band of ZCSR in 1M11-8M14



Source(s): Company, Bloomberg, ABCI Securities estimates

Exhibit 8: P/B band of ZCSR in 1M11-8M14



Source(s): Company, Bloomberg, ABCI Securities estimates



Exhibit 9: Valuation of domestic and international rolling-stock manufacturers

Company	Ticker	Mkt cap (HK\$ mn)	CRY	As of 12/8/2014 Share Price	P/E (x)		EPS (%YoY)		P/B (x)		ROAE (%)	
					FY14E	FY15E	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
Domestic Rolling Stock Makers												
CSR-H	1766 HK	14,775	HKD	7.30	14.81	12.80	32.01	15.71	1.98	1.76	14.13	14.57
CSR-A	601766 CH	76,581	RMB	5.16	13.03	11.26	32.01	15.71	1.75	1.55	14.13	14.57
CNR-H	6199 CH	14,063	HKD	6.59	14.39	12.72	14.50	13.10	1.60	1.46	12.30	11.88
CNR-A	601299 CH	64,409	RMB	4.99	10.71	9.16	16.50	16.95	1.18	1.06	10.83	9.70
ZCSR	3898 HK	32,371	HKD	27.55	14.40	12.91	23.11	11.58	2.49	2.18	18.57	18.04
Zhuzhou Times	600458 CH	8,509	RMB	10.21	25.53	19.26	90.48	32.50	2.20	2.09	8.70	11.01
Changchun Eurasia Group	600697 CH	3,686	RMB	18.39	9.50	7.71	25.71	23.14	1.80	1.48	22.71	21.06
Jinxi Axle	600495 CH	9,751	RMB	11.53	31.76	30.34	70.82	4.68	2.96	2.68	6.37	9.27
Sector 's Weighted Average					14.00	12.16	28.98	15.59	1.77	1.58	13.31	13.25
International Rolling Stock Makers												
Alstom	ALO FP	83,641	EUR	26.16	11.05	9.81	31.50	12.63	1.34	1.23	13.76	11.57
Bombardier Inc	BBD/A CN	47,971	CAD	3.92	9.37	8.42	23.23	11.26	2.37	1.99	27.72	25.38
CAF	CAF SM	10,590	EUR	298.65	9.95	9.09	14.07	9.52	1.34	1.21	14.32	13.99
Vossloh A.G.	VOS GR	7,292	EUR	52.90	(35.82)	15.87	(218.16)	(325.66)	1.69	1.55	(17.09)	9.58
Faiveley Transport	LEY FP	8,035	EUR	53.15	13.13	12.16	15.63	7.98	1.25	1.15	9.94	9.85
Nippon Sharyo	7102 JP	4,048	JPY	364.00	17.50	14.62	(56.67)	19.71	0.80	0.77	11.86	5.37
Kinki Sharyo	7122 JP	1,660	JPY	317.00	(14.61)	27.33	(74.74)	(153.46)	0.65	0.63	(4.33)	2.34
Sector 's Weighted Average					8.39	10.04	12.74	(4.83)	1.63	1.44	16.10	15.36
Overall Weighted Average					11.63	11.27	22.13	6.98	1.71	1.52	14.48	14.14

Source(s): Bloomberg, ABCI Securities estimates



Financial statements of the Group

Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	7,186	8,781	10,263	11,330	12,235
Train-borne electrical systems (Locomotives)	1,584	2,906	1,875	2,578	2,042
Train-borne electrical systems (MUs)	2,229	2,315	4,740	3,942	3,794
Train-borne electrical systems (Metro)	928	956	1,171	1,621	1,826
Train-borne electrical systems (Others)	1,589	1,674	1,734	2,170	2,672
Electric components and others	856	930	744	1,018	1,900
COGS	(4,803)	(5,695)	(6,662)	(7,278)	(7,923)
Gross profit	2,383	3,086	3,601	4,052	4,312
SG&A	(1,197)	(1,503)	(1,582)	(1,795)	(1,934)
Other income and gains	218	121	108	116	127
Pre-tax profit	1,404	1,704	2,127	2,373	2,505
Income tax	(179)	(238)	(319)	(356)	(376)
Net profit	1,225	1,466	1,808	2,017	2,129
Profit attributable to:					
Minority interests	1.0	(1.0)	1.9	1.8	1.7
Equity shareholders of the Company	1,224	1,467	1,806	2,015	2,127
FD EPS (RMB)	1.129	1.248	1.536	1.714	1.810
DPS (RMB)	0.350	0.350	0.461	0.514	0.543
EBIT	1,420	1,707	2,133	2,377	2,509
EBITDA	1,577	1,875	2,313	2,568	2,709

*: Revenue is excluding business tax and surcharges
Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2012A-2016E)

As of Dec 31 (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Current assets	7,203	10,813	12,300	13,902	15,743
Cash and equivalent	2,319	3,136	3,448	4,082	5,638
Trade and bill receivables	3,628	4,908	5,215	5,960	6,107
Inventories	1,110	1,428	2,222	2,363	2,412
Other current assets	146	1,341	1,415	1,497	1,586
Non-current assets	2,454	2,586	2,774	2,966	3,160
Property, plant and equipment	1,701	1,830	1,952	2,064	2,169
Land lease prepayment	160	173	182	191	200
Intangible assets	111	74	73	74	77
Long term investments	255	233	256	282	310
Other non-current assets	227	276	311	355	404
Total assets	9,657	13,399	15,074	16,868	18,903
Current liabilities	3,033	3,821	4,053	4,341	4,806
Trade and bill payables	1,988	2,679	2,797	2,986	3,309
Receipts in advance	292	388	456	476	530
Short term borrowings	41	31	5	5	5
Other current liabilities	712	723	795	875	962
Non-current liabilities	305	428	454	485	530
Long-term borrowings	28	52	40	30	30
Other non-current liabilities	277	376	414	455	500
Total liabilities	3,338	4,249	4,506	4,826	5,337
Minority interests	135	134	135	137	138
Shareholders' equities	6,184	9,016	10,433	11,906	13,429
BVPS (RMB)	5.703	7.670	8.875	10.129	11.424

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2012A-2016E)

FY ended Dec 31 (RMB mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Profit before tax	1,404	1,704	2,127	2,373	2,505
Changes in depreciation and amortization	157	168	180	190	200
Changes in working capital	(201)	(831)	(936)	(578)	151
Financial cost	16	3	(6)	(4)	(4)
Income tax paid	(129)	(318)	(299)	(334)	(352)
Others	-	-	-	-	-
CF Operating	1,247	726	1,066	1,646	2,500
Increase in PP&E	(337)	(275)	(280)	(280)	(280)
Increase in intangible assets	(30)	2	(30)	(33)	(36)
Others	383	(1,054)	-	-	-
CF Investing	16	(1,327)	(310)	(313)	(316)
Capital injection	10	1,776	-	-	-
Net debt financing	(632)	28	(38)	(10)	-
Dividend payout	(369)	(380)	(411)	(542)	(605)
Interest paid	(28)	(3)	6	4	4
Others	-	-	(0)	(152)	(27)
CF Financing	(1,019)	1,422	(444)	(699)	(627)
Net change in cash	244	821	312	634	1,556
Cash at the beginning	2,158	2,319	3,136	3,448	4,082
Adjustment (Time deposit & FX effect)	(83)	(4)	-	-	-
Cash at the end	2,319	3,136	3,448	4,082	5,638

*: We rearrange the cash flow statement for better comparison reason, such that the operating cash flow is including the interest received, while the investing cash flow is excluding the interest received

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2012A-2016E)

FY ended Dec 31	FY12A	FY13A	FY14E	FY15E	FY16E
Sales mixed (%)					
Train-borne electrical systems (Locomotives)	22.04	33.09	18.27	22.75	16.69
Train-borne electrical systems (MUs)	31.02	26.36	46.18	34.79	31.01
Train-borne electrical systems (Metro)	12.91	10.89	11.41	14.31	14.93
Train-borne electrical systems (Others)	22.11	19.06	16.89	19.15	21.84
Electric components and others	11.91	10.59	7.25	8.99	15.53
Profit & loss ratios (%)					
Gross margin	33.16	35.14	35.09	35.77	35.25
Net profit margin	17.03	16.71	17.60	17.79	17.39
Effective tax rate	12.75	13.97	15.00	15.00	15.00
Growth (%)					
Revenue	1.51	22.20	16.88	10.39	7.99
Gross profit	(3.92)	29.50	16.69	12.53	6.42
EBIT	0.46	20.21	24.94	11.47	5.55
EBITDA	(2.51)	18.90	23.36	11.01	5.51
Net profit	3.34	19.85	23.11	11.58	5.57
Balance sheet ratios					
Current ratio (x)	2.37	2.83	3.04	3.20	3.28
Quick ratio (x)	2.01	2.46	2.49	2.66	2.77
Cash ratio (x)	0.76	0.82	0.85	0.94	1.17
Trade and bill receivables days	147	177	180	180	180
Trade and bill payables turnover days	127	150	150	145	145
Inventory turnover days	106	81	100	115	110
Total debt / equity ratio (%)	1.09	0.91	0.43	0.29	0.26
Net debt / equity ratio (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Returns (%)					
ROAE	21.29	19.30	18.57	18.04	16.79
ROAA	13.37	12.73	12.69	12.62	11.89
Payout ratio	31.00	28.04	30.00	30.00	30.00

Source(s): Company, ABCI Securities estimates



Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2007-2011

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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