

Analyst: Kelvin Li

## **Main Board H-share Listing – Research**

中國南車股份有限公司

China South Locomotive & Rolling Stock Corporation Limited [Stock Code: 01766]

**Joint Global Coordinators, Joint Bookrunners, :** CICC Macquarie Capital  
**Joint Lead Managers and Joint Sponsors**

**Sector :** Capital goods

**Business :** Manufacture of rolling stock products and provision of related services

**Total share offer:** 1,600,000,000 H shares  
(13.79% of the enlarged share capital)

*Remark: 160 million non-tradable Domestic Shares will be converted into H shares and held by National Council for Social Security Fund (NSSF) of the PRC. As a result, the total issued and converted H shares will account for 15.17% of the enlarged share capital upon completion of the Global Offering and the A-share Offering, assuming the Over-allotment Option was not exercised.*

**Public Offer:** 160,000,000 H shares (10%)

**Placing:** 1,440,000,000 H shares (90%)

**Greenshoe:** 240,000,000 H shares

**Price:** HK\$2.49 – HK\$2.76 per H share

**H-share Market Cap:** HK\$4.38 bln-HK\$4.86 bln

**Pro forma fully diluted FY08E P/E:** 18.6x-20.6x  
*(based on an estimated profit attributable to equity-holders of RMB1.36 billion in 2008 and assuming the A-share Offering is completed with 3.0 billion A shares newly issued and the over-allotment option is not exercised.)*

**Adjusted NTA per H share:** HK\$1.36-HK\$1.42  
*(assuming the A-share offering is completed with 3.0 billion A shares newly issued at RMB2.10-RMB2.18)*

**Staffing:** 79,575 (as of 31<sup>st</sup> March 2008)

**HK Public Offer period:**

8<sup>th</sup> August 2008 - 13<sup>th</sup> August 2008 noon

**Receiving bank:** Bank of China (Hong Kong)  
ICBC (Asia)  
Standard Chartered Bank  
HSBC

**Share registrar:** Computershare Hong Kong  
Investor Services Limited

**Listing date:** 21<sup>st</sup> August 2008

### **Business of China South Locomotive & Rolling Stock ("CSR")**

CSR, parent of the HK-listed Zhuzhou Times New Electric (HKEx: 03898), is one of the largest rolling stock (a collective term describes vehicles that move on a railway) manufacturers and solutions providers in the world, offering a wide range rolling stock products and services. It was also the top rolling stock manufacturer in Mainland China in 2007 in terms of revenue.

CSR is mainly engaged in the research & development, manufacturing, sales, refurbishment and leasing of rolling stock, including locomotives, passenger carriages, freight wagons, multiple units (MUs), rapid transit vehicles and key related components as well as other businesses that utilize proprietary rolling stock technology.

CSR's products could be divided into five major categories, namely locomotives, passenger carriages, freight wagons, MUs and rapid transit vehicles. Locomotives mainly consist of various types of electric and diesel locomotives. Passenger carriages consist of seating coaches, berth sleeping cars, dining cars, power generation cars and double-deck passenger carriages. Freight wagons comprise open top wagons, flat wagons, box wagons, tank wagons, hopper wagons and other special purpose vehicles. MUs consist of train units with maximum speed up to 200km/h, over 200km/h and over 300km/h. Rapid transit vehicles include metro cars and light rail cars.

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### Shareholders after Listing (Assuming the over-allotment option is not exercised)

China South Locomotive & Rolling Stock Industry (Group) Corporation ("CSRG"), a state-owned enterprise controlled by the State-Owned Assets Supervision and Administration Commission (SASAC)	58.13%
Beijing Railway Industry Trade Company – wholly owned by CSRG	0.84%
A share public investors	25.86%
H share public investors*	13.79%
H shares held by NSSF	1.38%
	<u>100.00%</u>

Remark: (\*) A group of 3 corporate investors has agreed to subscribe for an aggregate US\$90 million or about 16.7%-17.6% of the H-share offering. Subscriptions of the corporate investors include US\$30 million each for:

1. China Life Insurance (HKEx: 02628)
2. GE Capital Equity Investments Ltd
3. Mirae Asset Global Investments (Hong Kong) Limited

### Use of Proceeds

Net proceeds from the offer are estimated to be HK\$3.94 billion (assuming an offer price of HK\$2.625, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
To acquire advanced foreign research and development, manufacturing and laboratory equipment to develop rolling stock manufacturing facilities.	1,064.9 (27%)
To import critical components, including electric components for six-axle high-powered AC electric locomotives, which facilitate the domestic production of complete rolling stock-units.	2,327.1 (59%)
To import key foreign technologies for rail vehicles to upgrade the quality and efficiency of our products, design and manufacturing.	552.2 (14%)

Remark: CSR also launched a Shanghai A-share IPO, raising as much as RMB6.54 billion. The proceeds raised from the A-share issue would be used for the industrialisation and production of high-speed electric MUs and high-powered locomotives, enhancements of R&D and production of rapid transit vehicles, enhancement of product quality, technology and information system, and the development of know-how in businesses using rolling stock related technologies.

### Financial Highlights

	Year ended 31 <sup>st</sup> Dec			3 months ended	
	2005	2006	2007	31 <sup>st</sup> Mar 2007	31 <sup>st</sup> Mar 2008
	RMB million	RMB million	RMB million	RMB million	RMB million
Revenue	19,785	23,047	26,804	6,066	6,586
Gross profit	2,690	3,244	4,019	845	1,198
Operating profit	759	633	1,070	207	637
<b>Profit attributable to shareholders</b>	<b>407</b>	<b>545</b>	<b>613</b>	<b>102</b>	<b>368</b>
Gross profit margin	13.59%	14.07%	14.99%	13.92%	18.20%
Operating profit margin	3.84%	2.75%	3.99%	3.42%	9.67%
Net profit margin	2.06%	2.36%	2.29%	1.67%	5.58%
	<b>31/12/2005</b>	<b>31/12/2006</b>	<b>31/12/2007</b>	<b>31/03/2007</b>	<b>31/03/2008</b>
Net debt/(cash) to Equity	84.16%	5.62%	13.29%	N/A	85.80%

### Revenue breakdown in terms of business segments

(RMB billion)	2005	%	2006	%	2007	%	3M07	%	3M08	%
Locomotives	6.68	34%	7.17	31%	7.09	26%	1.28	21%	1.72	26%
Passenger carriages	2.92	15%	3.42	15%	3.41	13%	0.99	16%	0.80	12%
Freight wagons	7.18	36%	8.07	35%	9.19	34%	2.34	39%	2.16	33%
MUs	0.07	0%	1.11	5%	2.68	10%	0.66	11%	0.79	12%
Rapid transit vehicles	1.22	6%	1.23	5%	1.70	6%	0.27	4%	0.25	4%
Others	1.71	9%	2.04	9%	2.74	10%	0.52	9%	0.86	13%
<b>Total</b>	<b>19.78</b>	<b>100%</b>	<b>23.05</b>	<b>100%</b>	<b>26.80</b>	<b>100%</b>	<b>6.07</b>	<b>100%</b>	<b>6.59</b>	<b>100%</b>

**Production volume of various segments**

	2005	2006	2007
Locomotives – manufacturing (cars)	564	495	346
Locomotives – refurbishment (cars)	862	760	937
Passenger carriages – manufacturing (cars)	772	932	685
Passenger carriages – refurbishment (cars)	1,946	1,885	1,961
Freight wagons – manufacturing (cars)	16,508	15,523	17,319
Freight wagons – refurbishment (cars)	30,120	29,443	28,959
MUs – manufacturing (units)	4	240	523
Rapid transit vehicles – manufacturing (units)	206	201	262

**Strengths/Opportunities**

- ✓ CSR is the largest rolling stock manufacturer in the Mainland, which gives investors a direct investment proxy to ride on the fast growing infrastructure spending on railway construction in China.
- ✓ The Chinese government has called for, in its 11<sup>th</sup> Five-Year Plan, a total investment of about RMB1.25 trillion to develop railway network in 2006-2010, up nearly 3 times from the corresponding amount in the 10<sup>th</sup> Five-Year Plan (2001-2005), in order to grow the total national railway length from 75,000km to 90,000km or at annual rate of 3,000km during the five-year period. CSR should see strong demand for rolling stock products and enormous business opportunities arising from the expanding railway system in China.
- ✓ Besides enlarging size and geographical coverage, the Chinese government also plans to upgrade the national railway system to enhance service quality, speed, efficiency and reliability. Via the upgrade program, CSR should see better demand for its high-end products like high-powered locomotives, electric multiple units and rapid transit vehicles.
- ✓ To cope with rising demand for mass transportation in urban areas, the Mainland authorities have emphasized the need for the development of rapid transit systems and are planning to allocate about 30%-50% of its railway investment budget to the segment. It is forecast that there would be an annual demand for 1,200 new rapid transit vehicle units in the next few years, compared with CSR's output of 262 units last year. During 2005-2007, the rapid transit vehicle segment accounted for about 4% of CSR's total revenue. It is expected that the segment would make up a greater portion of revenue contribution and become one of the key growth drivers in coming years.
- ✓ CSR's profit margins sharply improved during the first three months of this year, as the Group shift its profit mix to high-end products like high-power electric locomotives and electric MUs. The positive trend in profit margins is expected to hold well, as the Chinese is pushing forward the upgrade of the national railway system.

**Weaknesses/Threats**

- ✗ The Ministry of Railways of PRC and related parties were CSR's biggest clients, accounting for more than 60% of total revenue in the last couple of years. As such, any slowdown or delay in government's public spending on railway development may lead to reduction in product demand and drag the Group's growth momentum.
- ✗ CSR plans to expand its business overseas and strengthen its global presence. Nonetheless, the growth pace of overseas market lagged behind that of the domestic market last year and even saw a sharp 50.2% y-o-y revenue drop in the first quarter this year, due to a sluggish global economy. Besides, high transportation costs in product shipment may also weaken CSR's relative cost advantage.

**Recommendation:     Subscribe**



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