

**Analyst: Vincent Leung**

## Main Board Listing – Research

**中國自動化集團有限公司**
**China Automation Group Limited [Stock Code: 0569]**
**Sponsor** : First Shanghai

**Joint Bookrunners and Joint Lead Managers** : First Shanghai

Daiwa Securities SMBC

**Sector** : Software & Services

**Business** : Provision of safety and critical control systems and related engineering and maintenance services as well as trading of petrochemical instruments and train manufacturing equipment

<b>Total share offer:</b> <u>200,000,000</u> shares <b>(25% of the enlarged share capital)</b>  <b>Public Offer:</b> 20,000,000 shares (10%) <b>Placing:</b> 180,000,000 shares (90%) <b>Greenshoe:</b> 30,000,000 shares	<b><u>Business of China Automation Group</u></b>  The Group is one of the leading safety and critical control system providers for the petrochemical, oil and gas and railway industries in the PRC. According to Frost & Sullivan*, the Group is the largest safety and critical control system provider in the PRC in 2006 with a market share of approximately 68% in terms of revenue. The Group is principally engaged in the provision of safety and critical control systems and related engineering and maintenance services. It is also engaged in the trading of petrochemical instruments and train manufacturing equipment.  The Group's safety and critical control systems, including ESD (Emergency Shutdown Device), FGS (Fire and Gas Systems), ITCC (Integrated Turbine and Compressor Control) and RIS (Railway Interlocking System), typically comprise hardware sourced from suppliers and self-developed application software. The Group's safety and critical control systems are sold to customers in different industries such as petrochemical, oil and gas, iron and steel, and railway. The Group's safety and critical control systems are mainly used to minimise industrial safety risk and to protect, monitor and control critical production equipment.
<b>Price:</b> HK\$1.19 – HK\$1.53 per share  <b>Market Cap:</b> HK\$952 million – HK\$1,224 million  <b>Fully-diluted FY2006 P/E:</b> 14.0x – 18.0x  <b>Adjusted NTA per share:</b> HK\$0.451 – HK\$0.534  <b>Staffing:</b> 249 (as of 25 <sup>th</sup> June 2007)	
<b>Public Offer period:</b> 28 <sup>th</sup> June 2007 – 4 <sup>th</sup> July 2007 noon  <b>Receiving bank:</b> ICBC (Asia)  <b>Share registrar:</b> Tricor Investor Services Limited  <b>Listing date:</b> 12 <sup>th</sup> July 2007	

*Remark (\*): The research report prepared by Frost & Sullivan on the Chinese Safety and Critical Control Systems Market in May 2007 was commissioned by the Group at a fee of RMB160,000.*

### **Shareholding Structure after Listing** (Assuming the over-allotment option is not exercised)

Mr. Zuan Rui Guo (aged 38; founder, an executive director and chairman)	16.89%
Mr. Huang Zhi Yong (aged 40; co-founder, an executive director)	16.89%
Mr. Kuang Jian Ping (aged 42; co-founder, an executive director)	33.79%
Mr. Wei Yuqian (independent 3 <sup>rd</sup> party)	7.43%
Public investors	25.00%
	<u>100.00%</u>

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**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$249.5 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.36 each, being the midpoint of the indicative price range)

	HK\$ million
For R&D expenditure	40
For the construction of a new complex comprising R&D centre, production facilities and office premises	40
For expanding and improving the Group's sales network in the PRC	30
For expanding and improving the Group's service network in the PRC	25
For setting up offices in Dubai and Canada for the provision of engineering services in the Middle East and North America respectively	30
For pursuing suitable acquisition to expand the Group's business horizontally and/or vertically	60
For general working capital	balance

**Financial Highlights**

	Year ended 31 <sup>st</sup> December		
	2004 RMB'000	2005 RMB'000	2006 RMB'000
Turnover	165,370	264,356	289,037
Gross profit	61,071	86,673	124,107
Operating profit	39,053	54,348	76,890
<b>Attributable profit</b>	<b>35,291</b>	<b>45,330</b>	<b>68,471</b>
Gross margin	36.9%	32.8%	42.9%
Operating margin	23.6%	20.6%	26.6%
Net margin	21.3%	17.1%	23.7%

**Revenue Breakdown (% of Total Revenues)**

	Year ended 31 <sup>st</sup> December		
	2004 %	2005 %	2006 %
ITCC	37.3%	33.9%	39.0%
ESD & GFS	33.9%	22.8%	23.0%
RIS	5.4%	12.9%	13.5%
System sales	76.6%	69.6%	75.6%
Provision of engineering & maintenance services	4.7%	9.9%	15.9%
Trading of equipment	18.7%	20.5%	8.5%
Total	100.0%	100.0%	100.0%



## **Strengths/Opportunities**

- ✓ According to Frost & Sullivan, there are around 10 players in the safety and critical control system market in the PRC and the Group was the market leader with a market share of approximately 68% in terms of revenue in 2006. The 2<sup>nd</sup> largest player was New York-listed Honeywell, which commanded a market share of just 8.0% in 2006.
- ✓ The Group has established a customer base comprising sizable and reputable companies in the PRC, such as China Petrochemical International, China Petroleum & Chemical Corporation (Sinopec, stock code: 0386), PetroChina (stock code: 0857) and Beijing Huatie Information Technology Development Company, as well as some members of companies listed on the Main Board of the Hong Kong Stock Exchange.
- ✓ To be priced at 14x-18x historical FY2006 P/E, China Automation's valuation is not demanding when compared with Hong Kong-listed system integration providers. China Fire Safety (stock code: 8201), ZNode Technologies (stock code: 2371) and Enric Energy Equipment (stock code: 3899) are trading at historical FY2006 P/E of 16.5x, 20.5x and 31.2x respectively.

## **Weaknesses/Threats**

- × The Group has been reliant on a few key suppliers, with its top 5 suppliers accounted for approximately 68.0%, 70.5% and 85.6% of the total raw materials & component purchase costs for the 3 years ended 31<sup>st</sup> December 2006 respectively while the largest supplier accounted for 53.9%, 31.4% and 64.2% respectively.
- × The Group has been reliant on the licensing distribution agreement of Triconex hardware (for safety, critical control and turbomachinery applications) from Invensys, and the Group's revenue contribution generated from system sales based on the hardware/platform supplied by Invensys had accounted for approximately 76.6%, 69.6% and 75.6% for the 3 years ended 31<sup>st</sup> December 2006 respectively. Changes in its relationship with Invensys could adversely affect the Group's operations because its software is sold with Triconex hardware. Although the Group signed an exclusive 3-year contract with Invensys in February 2006 to distribute Triconex products in the PRC, such agreement may be terminated by either party by giving a minimum 60-day written notice to the other party.

**Recommendation:    Neutral**

**Important Disclosure / Analyst Certification / Disclaimer**

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