

Analyst: Kelvin Li

Main Board Listing – Research

中國高速傳動設備集團有限公司

China High Speed Transmission Equipment Group Co., Ltd. [Stock Code: 0658]
Sole Global Co-ordinator, Sponsor, Bookrunner and Lead Manager : Morgan Stanley

Sector : Capital goods

Business : Production of mechanical transmission equipment

Total share offer: <u>300,000,000</u> shares (25% of the enlarged share capital) Public Offer: 30,000,000 shares (10%) Placing: 270,000,000 shares (90%) Greenshoe: 45,000,000 shares	<u>Business of China High Speed</u> China High Speed Transmission Equipment is one of the leading mechanical transmission equipment producers in the PRC. The Group is also the leading supplier of mechanical transmission equipment for wind turbines in the Mainland, with a market share of about 90% in 2006. The Group mainly engages in the research, design, development, manufacture and distribution of a broad range of mechanical transmission equipment used in a wide range of industrial applications including wind power generation, marine vessels, rail transport, aerospace, metallurgy, petrochemicals, construction and mining.
Price: HK\$5.38 – HK\$7.08 per share Market Cap: HK\$6.46 billion – HK\$8.50 billion Pro forma FY2007E PER: 35.2x to 46.3x Adjusted NTA per share: HK\$1.65 – HK\$2.06 Staffing: 2,241 (as of 31 st December 2006)	
HK Public Offer period: 20 th June 2007 – 25 th June 2007 noon Receiving bank: Bank of Communications (HK) Bank of China (Hong Kong) Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 4 th July 2007	

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

Fortune Apex, owned by Management Shareholders* and one of the Controlling group members	27.45%
Luckever [^] , owned by Mr. Liu Xuezhong & his wife Ms. Li and one of the Controlling group members	13.13%
New VPL Funds/Sub-Funds	7.86%
Wiaearn, owned by Mr. Pan Jinhong and one of the Controlling group members	5.02%
GE Capital	5.00%
DPF	4.53%
Templeton	4.53%
Wise Win, owned by Jiangsu Hi-Tech Venture Capital	3.46%
SOF (I), a close-ended fund	3.42%
Other individual investors	1.85%
Public investors	23.75%
	<u>100.00%</u>

Remark: (*) Management shareholders mainly comprise executive directors and senior management of the Group. Mr. Hu Yueming, the Group's chairman, was the single largest stakeholder in Fortune Apex with a 30.38% interest. (^) Mr Zhu Keming, a non-executive director, was nominated by Luckever.

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,715 million (Assuming an offer price of HK\$6.23, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For research, development and further production capacity expansion in relation to wind gear transmission equipment	1,029
For research, development and production of marine gear transmission equipment and other marine vessel related products	343
For research, development and production of mechanical transmission equipment for light rails and high-speed rails	85.75
For investments in production facilities to manufacture raw materials for critical components (such as forged steel and cast iron products) for the Group's products	85.75
For general working capital	171.5

Financial Highlights

	NGC		The Group	
	From 1 Jan 04 to 25 Feb 04	From 26 Feb 04 to 31 Dec 04	2005	2006
(RMB in million)				
Revenue	79.4	688.9	946.7	1,184.3
Gross profit	29.9	199.2	274.6	340.8
Operating profit	12.4	94.5	133.8	156.2
Attributable profit to shareholders	7.4	37.8	81.7	85.6
Gross profit margin	37.66%	28.92%	29.01%	28.78%
Operating profit margin	15.62%	13.72%	14.13%	13.19%
Net profit margin	9.32%	5.49%	8.63%	7.23%

Breakdown of revenue in terms of products

	NGC		The Group	
	From 1 Jan 04 to 25 Feb 04	From 26 Feb 04 to 31 Dec 04	2005	2006
(RMB in million)				
	%	%	%	%
High-speed series gear transmission equipment	1.0	22.7	27.5	17.7
Gear transmission equipment for construction material	35.1	285.9	307.8	195.4
General purpose gear transmission equipment	9.6	78.0	90.2	139.2
Gear transmission equipment for bar-rolling, wire-rolling and plate-rolling mills	24.9	146.1	301.0	289.2
Wind gear transmission equipment	-	0.7	26.5	317.7
Marine gear transmission	-	-	0.7	3.2
Others*	8.9	155.6	192.9	221.9
Total	79.4	688.9	946.7	1,184.3

Remark: (*) Others refer to mechanical transmission equipment for a variety of other applications, including mechanical transmission equipment for rubber production, mechanical transmission equipment for mixers, mechanical transmission equipment for coupling machines and customised mechanical transmission equipment and related spare parts. It also includes spare parts, engineering gears and locomotive gears.

Strengths/Opportunities

- ✓ According to market research, the wind power industry grew at a CAGR of more than 24% worldwide between 2001 and 2006. Owing to the rising concern over scarcity of transitional energy resources like oil and coal, investment in wind power is expected to grow strongly in the future, which should also help lift the demand for wind gear transmission equipment.
- ✓ The National Development and Reform Commission (NDRC) said in its latest report that China is expected to add 2 GW of wind power generating capacity this year, up 77% from the total capacity of 2.6 GW as at the end of 2006. The NDRC report also claims that China could also lift its wind power generating capacity to 10 GW by 2010 and even top 100 GW by 2020 if relevant policies were perfected and implemented forcefully. As the leading equipment supplier in the wind turbine industry, the Group is well positioned to ride on the strong growth outlook of the Mainland's wind power industry.
- ✓ The Group also sees enormous business opportunities in the overseas markets. The Group's export sales amounted to RMB138.1 million in 2006 and accounted for 11.7% of the total revenue, up 57% y-o-y from RMB78.6 million a year earlier, which accounted for 8.3% of 2005's total.
- ✓ The Group's pre-tax profit fell 16.8% y-o-y to RMB93.7 million in 2006 from RMB112.6 million a year earlier, mainly due to a RMB20.1 million revaluation loss from convertible bonds. However, as the bonds were converted into shares in December 2006, there will not be any revaluation gain or loss from convertible bonds this year. Meanwhile, the Group management forecast a net profit of no less than RMB180 million in 2007, up a sharp 109% from a year earlier.

Weaknesses/Threats

- × Metals and related raw materials are the key component in the Group's cost of goods sold. In 2006, it accounted for 62.7% of the Group's total COGS, up from 58% in 2005. Owing to rising base metal prices and other raw material costs, the Group experienced pressure on profit margins. Nonetheless, thanks to strong volume growth, the Group managed to maintain its gross margins at near 29% over the last couple of years, as healthy profit margins in key business segments offset weak margin in other low-end mechanical transmission equipment products like spare parts and engineering gears.
- × Wind power industry on the Mainland should provide the Group with enormous business opportunities. However, to be priced at 46x (at the top end of the indicative price range) forward price-earnings multiple, valuation of the issue is rich when compared with other listed machinery manufacturing peers.

Recommendation: Neutral

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