

Analyst: Stanley Lau

Main Board H-share Listing – Research

上海電氣集團股份有限公司

Shanghai Electric Group Company Limited [Stock Code: 2727]
Sole Global Coordinator, Bookrunner, Lead Manager and Sponsor

: Credit Suisse First Boston (Hong Kong) Limited

Sector : Capital goods

Business: Equipment provider in power, electromechanical, transportation and environmental sectors in China

<p>Total share offer: <u>2,972,912,000</u> H shares (25% of the enlarged share capital)</p> <p>Public Offer: 297,292,000 H shares (10%) Placing: 2,675,620,000 H shares (90%) Greenshoe: 445,936,000 H shares (15%)</p> <p>Price: HK\$1.50 – HK\$1.76 per H share Market Cap.: HK\$17.84 billion – HK\$20.93 billion</p> <p>Forecast FY2005 P/E: 12.6x – 14.8x (pro forma)</p> <p>Adjusted NTA per share: HK\$1.00 (Assuming an issue price of HK\$1.63, being the mid-point of the indicative price range)</p> <p>Staffing: 34,078</p>	<p><u>Business of Shanghai Electric</u></p> <p>Shanghai Electric is one of China's leading industrial conglomerates engaged in the design, manufacture and sale of (i) power equipment, (ii) electromechanical equipment, (iii) transportation equipment and (iv) environmental systems. The key businesses are power equipment and electro-mechanical equipment, which generated 47% and 35% of turnover in 2004 respectively.</p> <p>Its power equipment division comprises power generation, transmission and distribution equipment businesses. Shanghai Electric cooperates strategically with Siemens in producing turbines, turbine generators and auxiliary equipment for power stations. It was China's largest coal-fired power generation equipment manufacturer in 2004.</p> <p>Its electromechanical equipment division manufactures elevators, printing and packaging equipment, heavy machinery and machine tools. Its Joint Venture with Mitsubishi was the largest elevator manufacturer in China with a domestic market share of 18% in 2004.</p> <p>Shanghai Electric simultaneously engages in diesel engine business and metropolitan rail transportation equipment business, and provides environmental protection systems that range from pollution prevention to waste treatment.</p>
<p>HK Public Offer period: 18th April 2005 – 21st April 2005</p> <p>Receiving bank: HSBC, ICBC (Asia)</p> <p>Share registrar: Computershare Hong Kong Investor Services Limited</p> <p>Listing date: 28th April 2005</p>	

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

Shanghai Electric Corporation	51.58%
Fuxi Investment Holding Co, Ltd	8.15%
Guangdong Zhujiang Investment Co, Ltd	7.72%
Shenergy Group	4.12%
Shantou Municipal Mingguang Investment Co, Ltd	3.43%
Siemens *	1.25%
	<u>76.25%</u>

* 5% of Shanghai Electric's initial public offering, giving it 1.25% of the enlarged share capital.

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$4.2 billion.

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.63 each, which is the mid-point of the indicative price range)

	HK\$ million
Technology improvement and capacity expansion of production facilities, new joint ventures and product development in power equipment business	1,900
Technology improvement of production facilities and product development in electromechanical equipment business	1,400
To expand production and enhance product design capability of Shanghai Rail Traffic Equipment Development Co	330
To enlarge the scale of operations of the environmental system division	330
Working capital and other general corporate purposes	240

Financial Highlights

	Year ended 31 st December		
	2002 RMB million	2003 RMB million	2004 RMB million
Turnover	12,030	16,546	24,312
Operating profit	761	1,408	2,359
Operating profit margin	6.4%	8.5%	9.7%
Net profit	109	561	1,089
EBITDA	1,496	2,220	2,903
EBITDA Margin	12.4%	13.4%	11.9%
EPS – Basic	RMB1.19	RMB6.11	RMB11.85

Breakdown of Revenue by Business Segments

	Year ended 31 st December					
	2002 RMB million	%	2003 RMB million	%	2004 RMB million	%
Power Equipment Division	4,568	38.0	6,739	40.7	11,393	46.9
Electromechanical Equipment Division	5,089	42.3	6,605	39.9	8,485	34.9
Transportation Equipment Division	2,087	17.4	2,905	17.6	4,029	16.6
Environmental Systems Division	330	2.7	367	2.2	394	1.6
Other businesses	182	1.5	227	1.4	306	1.3
Consolidation adjustment	(226)	(1.9)	(297)	(1.8)	(295)	(1.3)
Turnover	12,030	100.0	16,546	100.0	24,312	100.0

Strengths/Opportunities

- ✓ Shanghai Electric has been benefiting from China's continued industrial production growth, which is driving demand for power and machinery equipment. China's GDP surged 9.5% in 2004 and is projected to grow 8% this year. Given its economies of scale and technical capabilities, Shanghai Electric has favourable competitive advantages over domestic rivals in capturing rising demand of industrial equipment in China.
- ✓ Its power equipment business is the main profit contributor, generating 52% of operating profit in 2004. Robust demand for power generation equipment under the current disparity between power supply and demand through construction of new power plants should continue to drive profitability of the segment. At the end of 2004, Shanghai electric had secured orders of RMB67.4 billion that would fully utilise its current production capacity through 2008. A quarter of these orders will be completed and booked in 2005, which implies an expected turnover growth of more than 30% from last year's RMB11.4 billion.



- ✓ Metropolitan rail equipment is a recently developed business to Shanghai Electric. Although revenue contribution from the operation is currently low at less than 1%, we believe the segment has high growth potential due to rapid development of urban transportation systems in China.
- ✓ Shanghai Electric has formed strategic alliances and joint ventures with several renowned international manufacturers such as Mitsubishi and Siemens. Such alliances have allowed the Company to gain access to their global distribution networks. For example, Shanghai Electric has started selling elevators overseas through Mitsubishi's distribution network. Meanwhile, Siemens has agreed to buy 5% of Shanghai Electric's initial public offering, giving it 1.25% of the Company after the flotation. The strategic investment will serve as a platform on which to further strengthen and underpin its strategic cooperation with Siemens.

Weaknesses/Threats

- × The mainland government's plan to clamp down overinvestment in the power sector is the biggest concern to Shanghai Electric. In response to this, the management said about 120 gigawatts of new capacity were permitted in February after regulatory approval was sought and it had required customers to pay a 100% cash advance for projects that had yet to receive approval. It will retain 10% of the deposits if the projects eventually fail to obtain regulatory approval.
- × Another concern is soaring raw material prices. The Company's EBITDA margin has been falling from 12.4% in 2002 and 13.4% in 2003 to 11.9% in 2004 due to a sharp increase in steel prices. Its long production cycle (of up to more than 18 months for power equipment) makes it vulnerable to raw material price fluctuation and difficult to pass on the cost to customers.
- × Shanghai Electric saw increased competition in its electromechanical equipment business, which dragged its EBITDA margin in the segment down from 18.2% in 2003 to 12.8% in 2004. The determining factor to maintain the segment's profitability would be whether business volume growth at its joint venture with Mitsubishi could counteract the impact from declining margins.
- × Shanghai Electric's valuation of 12.6x-14.8x FY2005E P/E is at a premium over that of its Chinese rivals. By comparison, Dongfang Electrical Machinery (*stock code*: 1072) and Harbin Power Equipment (*stock code*: 1133) are currently trading at 8x FY2005E P/E and 9x FY2005E P/E respectively.

Recommendation: Unappealing