

**Analyst: Vincent Leung**

## Main Board H-share Listing – Research

株洲南車時代電氣股份有限公司

Zhuzhou CSR Times Electric Co., Ltd. [Stock Code: 3898]

<b>Sole Global Coordinators, Sole Bookrunner,</b>	:	Macquarie Securities	
<b>Joint Sponsor and Sole Lead Manager</b>	:	CAF Securities	
<b>Joint Sponsor</b>	:	CAF Securities	BNP Paribas Peregrine
<b>Co-Lead Managers</b>	:	First Shanghai	Guotai Junan Securities
<b>Co-Managers</b>	:	Polaris Capital	

**Sector** : Electrical Equipment

**Business** : R&D, design, manufacture and sale of train-borne electrical systems and electrical components in the PRC

<p><b>Total H share offer:</b> <u>360,560,000</u> H shares (35% of the enlarged share capital)</p> <p><b>Public Offer:</b> 36,056,000 H shares (10%)</p> <p><b>Placing:</b> 324,504,000 H shares (90%)</p> <p><b>Greenshoe:</b> 54,084,000 H shares</p>	<p><b><u>Business of Zhuzhou CSR Times Electric (Zhuzhou CSR)</u></b></p> <p>Zhuzhou CSR is the leading train-borne electrical system provider and integrator for the PRC Railway industry. The Company possesses comprehensive capabilities in R&amp;D, design, manufacture, sales and customer service. It also engages in developing, manufacturing and selling train power converters, auxiliary power supply equipment and control systems for trains for urban rail systems, which is a focus of the Group's future business. It also designs, manufactures and sells electrical components for the PRC Railway industry, urban rail industry and non-railway applications.</p> <p>The Group's train-borne electrical systems are used in locomotives, passenger cars and trains for urban rail systems as the key equipment for power supply, controlling train operation and ensuring the safe operation. They are also used in large railway maintenance vehicles. Major customers are the Ministry of Railways and its local railway administrations, rail vehicle manufacturers and urban rail operators in the PRC.</p> <p>In 2005, the Group's train power converters, electronic control systems, train operation safety equipment, electrical control system for large railway maintenance vehicles and power semiconductor devices represented approximately 40%, 69%, 63%, 100% and 51% market shares in the domestic new rail vehicle market respectively.</p>
<p><b>Price:</b> HK\$4.18 – HK\$5.30 per H share</p> <p><b>H-share Market Cap:</b> HK\$1,658 million – HK\$2,102 million</p> <p><b>Pro-forma FY2006E P/E:</b> 16.1x – 20.4x</p> <p><b>Adjusted NTA per share:</b> HK\$2.10 – HK\$2.47</p> <p><b>Staffing:</b> 2,500 (as of July 2006)</p>	
<p><b>Bookbuilding Period:</b> 5<sup>th</sup> December 2006 – 13<sup>th</sup> December 2006</p> <p><b>HK Public Offer period:</b> 8<sup>th</sup> December 2006 – 13<sup>th</sup> December 2006 noon</p> <p><b>Receiving bank:</b> Standard Chartered Bank (HK)</p> <p><b>Share registrar:</b> Computershare Hong Kong Investor Services Limited</p> <p><b>Listing date:</b> 20<sup>th</sup> December 2006</p>	

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

CSR Zhuzhou Electric Locomotive Research Institute* (Domestic shares)	57.74%
National Council for Social Security Fund of the PRC (H shares)	3.50%
	<u>61.24%</u>

Remark (\*): 51% owned by China Southern Locomotive & Rolling Stock Industry (Group) Corporation ("CSR") and 49% owned by China Northern Locomotive & Rolling Stock Industry (Group) Corporation ("CNR")

**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$1,596 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$4.74 each, being the midpoint of the indicative price range)

	HK\$ million
For the development and commercialization related to train power converter, auxiliary power supply equipment and control systems	665
For the development and commercialization related to train safety operation equipment	174
For a technology import and commercialization project for developing a new generation of railway maintenance vehicles	35
For the development related to large size power semiconductor devices	361
For the capacity expansion of sensors and related products	118
For the establishment of an export & overseas sales network and ERP system as well as acquisition of 50% equity interest in Shiling and 17% equity interest in Siemens Zhuzhou from the Group's parent company	175
For general working capital	68

**Financial Highlights**

	Year ended 31 <sup>st</sup> December			Six months ended 30 <sup>th</sup> June
	2003	2004	2005	2006
	RMB million	RMB million	RMB million	RMB million
Turnover	658.8	787.8	998.0	633.9
Gross profit	270.4	323.1	455.7	307.5
Operating profit	86.6	187.6	232.4	165.9
<b>Attributable profit</b>	<b>98.5</b>	<b>162.7</b>	<b>211.7</b>	<b>153.3</b>
Gross margin	41.0%	41.0%	45.7%	48.5%
Operating margin	13.1%	23.8%	23.3%	26.2%
Net margin	15.0%	20.7%	21.2%	24.2%

**Turnover Breakdown (% of Total Turnover)**

	Year ended 31 <sup>st</sup> December			Six months ended 30 <sup>th</sup> June
	2003	2004	2005	2006
	%	%	%	%
Train-borne electrical systems	75.2%	77.1%	78.3%	83.5%
Electrical components	24.8%	22.9%	21.7%	16.5%
Total	100.0%	100.0%	100.0%	100.0%

**Strengths/Opportunities**

- ✓ Zhuzhou CSR is the leading railway electrical system provider and integrator for the PRC Railway industry. In 2005, the Group's train power converters, electronic control systems, train operation safety equipment, electrical control system for large railway maintenance vehicles and power semiconductor devices represented approximately 40%, 69%, 63%, 100% and 51% market shares in the domestic new rail vehicle market respectively. Its strong and leading market status enables it to sell its products at a gross margin in excess of 40% (45.7% gross margin in 2005).
- ✓ Under the 11<sup>th</sup> Five-year Plan, the Ministry of Railways (MOR) has earmarked RMB1,500 billion for railway-related spending, of which rail vehicles capex investment is estimated to be RMB250 billion during the period. Given its large size and dominant industry position, the Group will be able to capitalize on the PRC Railway-industry expansion under the 11<sup>th</sup> Five-year Plan (2006-2010).
- ✓ The Group plans to distribute about 40% of its earnings as dividends until the end of 2008.
- ✓ There is no real direct comparables given the uniqueness of Zhuzhou CSR as the only Chinese railway electrical system provider to be listed in Hong Kong. When compared with Chinese power equipment manufacturers Dongfang Electrical Machinery (stock code: 1072), Harbin Power Equipment (stock code: 1133) and Shanghai Prime Machinery (stock code: 2345), which are trading at FY2006E P/Es of 10.2x, 10.4x and 13.1x respectively, Zhuzhou CSR's valuation of 16.1x-20.4x FY2006E P/E is not attractive. However, given the prominent prospect of PRC's rail-equipment industry and its market-leading status, Zhuzhou CSR's higher valuation should be warranted.

**Weaknesses/Threats**

- × New orders for the Group's products are highly dependent on the levels of spending by the MOR or local governments on PRC Railway and urban rail projects, including replacement programmes and the construction & expansion of railway and transit systems. Any delay or cancellation of such projects will be detrimental to the Group's business.
- × The Group continues to face increasing competition from foreign firms, ever since the mainland started importing products and technologies from leading foreign locomotive manufacturers in late 2004. Moreover, rising competition from China Northern Locomotive & Rolling Stock Industry (Group) Corporation, which owns 49% of Zhuzhou CSR's parent company, is also a concern.
- × The Group's key customers are the rail vehicle manufacturers, the MOR and its local railway administrations. For the three years ended 31<sup>st</sup> December 2003-2005 and the six months ended 30<sup>th</sup> June 2006, sales to the Group's top five customers, most of which were rail vehicle manufacturers and local railway administrations, accounted for 49.9%, 41.9%, 35.7% and 45.9% of the Group's total turnover respectively. As a substantial portion of the Group's products have been and will be sold directly or indirectly through rail vehicle manufacturers to the MOR and its local railway administrations, a more stringent pricing policy adopted by the MOR would have an adverse impact on the Group's margin and profitability.

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