

Wasion Group (3393.HK)

Main beneficiary of smart power grid

Hong Kong | Power Equipment | Company report

23 December 2015

Wasion Group is a pioneering supplier of smart meters and power distribution as well as an integrated energy management solution provider in China. It owns outstanding core competitiveness. Since 2012, the company has consistently increased its investment in research & development (R&D), boosting the R&D expense ratio from 2% to 4% to strengthen its technological edge. Besides, the company also has built up brand recognition among its downstream customers. Leveraging on its all-rounded competitiveness in technology, quality, scale and management, the company maintains its competitive advantage in the smart meter tenders of the State Grid and China Southern Power Grid, enabling it to be the top three players of the industry.

At present, smart meter business accounts for around 1/3 of the company's revenue. There will be close to 120 million households installing smart meters in the coming several years. Besides, the replacement cycle of smart meters will be around 5-8 years according to the state regulation. As a result, the domestic demand for smart meters is expected to remain steady at a double-digit annual growth rate. Wasion Group is one the few successful bidders in almost all tenders of the State Grid and China Southern Power Grid, so we believe its smart meter business will at least achieve Synchronous growth.

During the 13th 5-Year Plan, the domestic smart grid will enter into the investment phase of the 2nd-generation AMI, which may create more business opportunities for the company. Meanwhile, the water, gas and heat business will also be the key to the company's growth momentum. What's more, there may also be better growth opportunities for its ADO business. Currently, the automation rate of the nation's power distribution is just at around 20%, which is far below the 50% level achieved by developed countries. The target of the Energy Bureau is to raise the level to 90% by 2020. Wasion Group is now speeding up its development in this business. We believe that the ADO business has entered into a fast-growing stage and will maintain a high growth rate of 50% or above in the medium term.

Main beneficiary of smart power grid

China's power reform will drive the development of smart grid, which will also significantly stimulate the demand for automated power distribution equipment. Wasion Group will be one of the major beneficiary. The reform of water pricing will also lead to further growth of the company. At the same time, profitability can be sustained at a high level with the improvement in product mix. The gross margin is expected to stay at 31% or above.

CAGR of the company's revenue and net profit was 20.6% and 26% respectively from 2010 to 2014. It is expected to deliver a rapid growth at 20% or above during the 13th Five-Year Plan. We forecast that the revenue of the company will reach RMB3.4 billion and RMB4.12 billion in 2015-16, representing an annual growth of 21% and 21.1%. Net profit is expected to reach RMB610 million and RMB740 million, representing an annual growth of 27.3% and 21.1%. Corresponding EPS will be RMB0.62 and RMB0.72.

No Rating

CMP: HKD 8.13
(Closing price as at 21 Dec 2015)
TARGET: N/A

COMPANY DAT

O/S SHARES (MN) :	1,027
MARKET CAP (HKDMN) :	8,350
52 - WK HI/LO (HKD):	12. 86/6. 34

SHARE HOLDING PATTERN • %

Star Treasure Investments Holdings Limited :	53. 25
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PRICE PERFORMANCE • %

	1M	3M	1Y
Wasion Group	-7.82	-7.72	10.01
HSI	-3.59	-7.88	18.67

PRICE VS. HSI



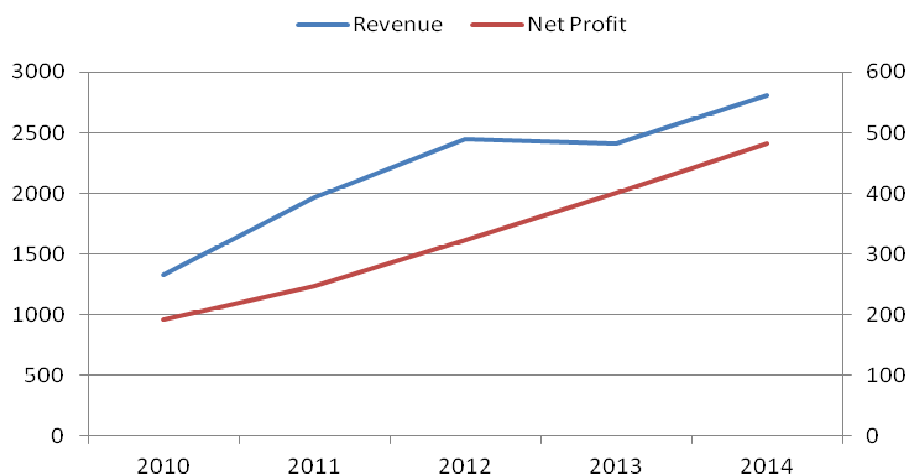
Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	2412	2812	3403	4122
Net Profit	401	482	614	744
EPS, CNY	0.43	0.51	0.62	0.72
PER, x	15.5	13.1	10.8	9.2
BVPS, CNY	3.08	3.41	4.22	4.71
P/BV, x	2.2	2.0	1.6	1.4
ROE, %	14.7	15.8	16.1	16.2
Debt/Equity (%)	65.02	69.94	73.91	73.91

Source: Company reports, Phillip Securities Est.

Research Analyst
Fan Guohe
(86 21 51699400-110)
fanguohe@phillip.com.cn

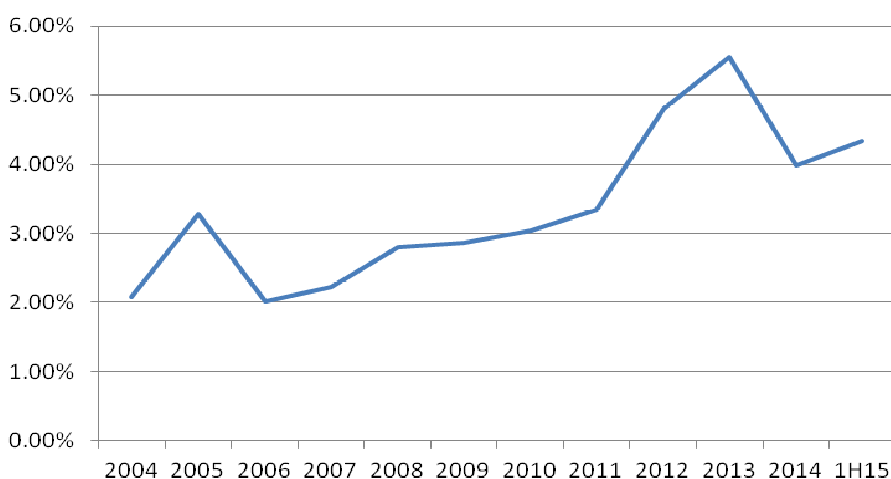
Improved performance of Wasion Group (RMB: mn)


Source: Company report, Phillip Securities (HK) Research

Outstanding core competitiveness

Wasion Group is a pioneering supplier of smart meters and power distribution as well as an integrated energy management solution provider in China. The company was established in 2000, initially just as an electricity meter manufacturer. It has actively developed into the upstream of the supply chain, by offering solutions to advanced metering infrastructure (AMI) and advanced distribution operations (ADO). These two segments have already contributed to 70% of revenue and enjoyed higher profit margins. In terms of business arena, the company has expanded into water, gas and heat meters.

The company has built up technological competitive advantage. Since 2012, the company has consistently increased its investment in research & development (R&D), boosting the R&D expense ratio from 2% to 4% to strengthen its technological edge. In 2015H1, the company received 44 patents for its new products and energy saving services and 21 patents for its software. The number of effective patents for new products and energy saving services are 605 and 392 respectively. At the same time, it has successfully gained market recognition by developing and launching a number of AMI systems and solutions. Among which, the “Power, Water, Gas and Heat All-in-one Data Collection System” has received pilot orders in Beijing, Shanghai and Shangdong.

% R&D expense of Wasion Group


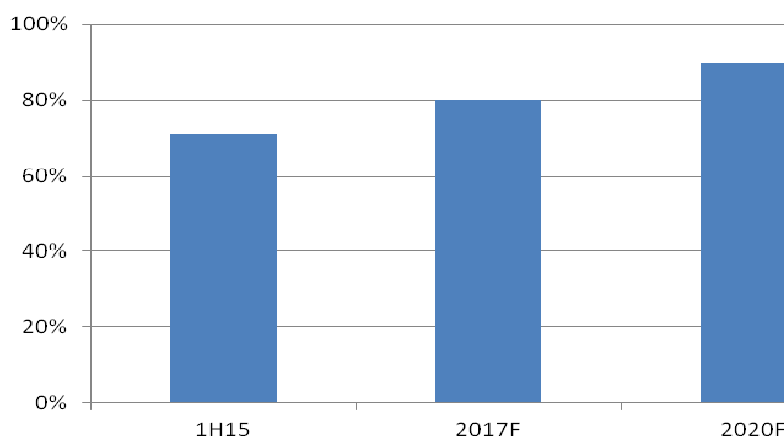
Source: Company report, Phillip Securities (HK) Research

Besides, the company also has built up brand recognition among its downstream customers. Leveraging on its all-rounded competitiveness in technology, quality, scale and management, the company maintains its competitive advantage in the smart meter tenders of the State Grid and China Southern Power Grid, enabling it to be the top three players of the industry.

Continued steady growth in its smart meter business

At present, smart meter business accounts for around 1/3 of the company's revenue. Overall speaking, the demand for this segment continues to be strong. By the end of 2015H1, the national coverage of smart meters has already reached 71% and there will be close to 120 million households installing smart meters in the coming several years. Besides, the replacement cycle of smart meters will be around 5-8 years according to the state regulation. As a result, the domestic demand for smart meters is expected to remain steady at a double-digit annual growth rate. Moreover, Wasion Group is one the few successful bidders in almost all tenders of the State Grid and China Southern Power Grid. In the four tenders of State Grid in 2014, contracts won by the company reached RMB1.2 billion, representing an increase of 69% yoy. Recently, the company maintained its top position by winning a contract value of RMB330 million again in the third round of tender of the State Grid. The cumulative contracts won for the full year reached RMB1.08 billion, further strengthening the company's leading position in the industry.

The market penetration of smart meter in China



Source: NEA, Phillip Securities (HK) Research

Upstream businesses will keep high growth

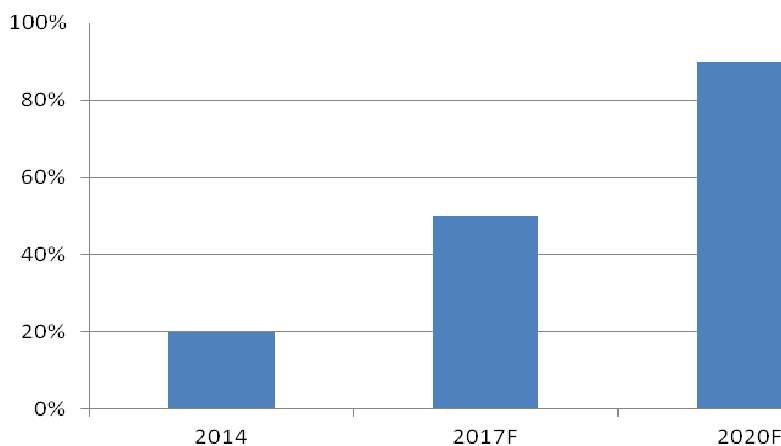
AMI is an integrated service platform that consists of smart meter, data collection terminal, information system and smart metering system integration that contributes to 60% of the company's revenue. At present, the company grabbed over 20% of market share in China's AMI electricity market. Not only does it occupy a pioneering position, it is also the only supplier in the market that can offer advanced meters in power, water, gas and heat as well as integrated energy efficiency solutions.

It is anticipated that AMI system can save around 5% of electricity bills and hold the key to smart grid's next stage of development. During the 13th 5-Year Plan, the domestic smart grid will enter into the investment phase of the 2nd-generation AMI, which may create more business opportunities for the company. Moreover, the water, gas and heat business will also be the key to the company's growth momentum. Benefiting from the strong promotion of "step-up" water tariffs and ten water policies, the revenue of Wasion's water, gas and heat business increased by 47% yoy to RMB85 million in 2015H1. It was successfully short-listed in the tenders of

34 water companies. Its full-year target is to sign contracts for 60 projects and the company is likely to outperform its target, securing growth opportunities for its water AMI business.

Besides, there may also be better growth opportunities for its ADO business. Currently, the automation rate of the nation's power distribution is just at around 20%, which is far below the 50% level achieved by developed countries. The target of the Energy Bureau is to raise the level to 90% by 2020. Wasion Group is now speeding up its development in this business and will use more than half of the new fund raised through the share placement to develop the ADO business. This includes the setting up of an investment platform to acquire and consolidate resources and the construction of the Wasion Power Industrial Park to serve as the manufacturing and R&D base of its ADO business. On the other hand, the company will strengthen the strategic partnerships with international electricity players such as Siemens, ABB and Schneider Electric. In H1, this business segment grew by more than 70%. We believe that the ADO business has entered into a fast-growing stage and will maintain a high growth rate of 50% or above in the medium term.

The Distribution automation rate in China



Source: NEA, Phillip Securities (HK) Research

Catalysts

The State Grid to announce its investment plan for 2016-2020;
More detailed announcements of the power reform.

Risks

Slower than expected development of the smart grid;
Risks in the overseas market;
Further decrease in gross margin.

Financials

FYE	2012	2013	2014	2015F	2016F
Valuation Ratios					
Price Earnings	19.0x	15.5x	13.1x	10.8x	9.2x
Price to Book	2.4x	2.2x	2.0x	1.6x	1.4x
Dividend Yield	2.2%	2.5%	2.9%	3.6%	4.2%
Per share data(RMB)					
EPS Adjusted	0.35	0.43	0.51	0.62	0.72
Book Value Per Share	2.79	3.08	3.41	4.22	4.71
Dividends Per Share	0.14	0.17	0.19	0.24	0.28
Growth & Margin					
Revenue growth	-	-1.6%	16.6%	21.0%	21.2%
Gross Profit growth	-	5.3%	13.7%	14.0%	17.4%
Net Profit growth	-	24.1%	20.3%	27.3%	21.1%
Profitability Ratios					
Gross Margin	32.8%	35.1%	34.2%	32.3%	31.3%
Net Profit Margin	13.2%	16.6%	17.2%	18.1%	18.0%
Dividend Payout Ratio %	41.4%	38.6%	38.3%	38.9%	38.7%
Key Ratios					
Return on Assets	7.4%	8.9%	9.3%	9.3%	9.3%
Return on Equity	13.0%	14.7%	15.8%	16.1%	16.2%
Effective Tax Rate	9.1%	8.8%	10.2%	10.0%	10.0%
Liability ratio	39.1%	39.4%	41.2%	42.5%	42.5%
Income Statement(RMB: mn)					
Revenue	2,452	2,412	2,812	3,403	4,122
- Cost of Goods Sold	1,648	1,566	1,849	2,305	2,834
Gross Income	805	847	963	1,097	1,288
- Selling, General & Admin Expenses	473	493	486	476	557
Operating Income	354	383	513	666	784
- Interest Expense	54	33	29	20	17
- Net Non-Operating Losses (Gains)	-56	-76	-64	-38	-60
Pretax Income	355	440	542	684	827
- Income Tax Expense	32	39	55	68	83
Income Before XO Items	323	401	486	615	745
Net Profit	323	401	482	614	744

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 21 Dec 2015)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005