

# China Railway Signal & Communication (3969.HK)

## Advantage Prominent but Undervalued

Hong Kong | TMT | Company report

3 May 2016

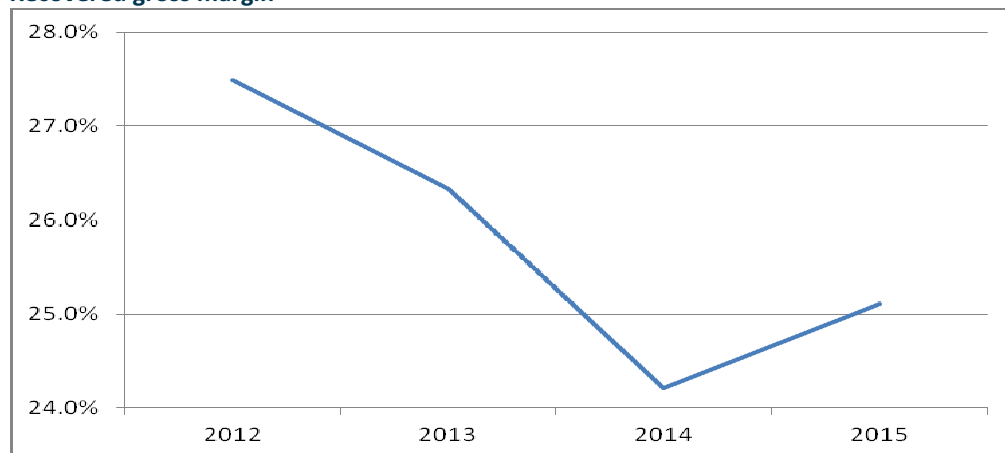
### Stable Growth in 2015

China Railway Signal & Communication (CRSC) is the world's largest solution provider for rail control system. With world's leading technology, it has monopolistic advantages in the field of railway signal, and is the leader in other rail traffic signal fields. In 2015, the company recorded the revenue of RMB23.95 billion, up 38.2% year-on-year. The net profit was RMB2.5 billion, an increase of 22.8%.

Among the three businesses, the revenue of design integration business increased by 18.3% to RMB5.808 billion, and the revenue of equipment manufacturing business grew by 17.6% to RMB6.9 billion, and that of the system delivery business increased by 38.6% to RMB7.44 billion. The three businesses were mainly benefited from the stable development of Chinese rail transit industry. In addition, the revenue of other businesses soared by 221.9% to RMB3.8 billion, which was also benefited from the company's efforts in vigorously developing related business besides devoting to signal business in the meantime.

As for the profitability, the company reversed the small decline in the last two years, resulting in a year-on-year increase in gross profit margin by 0.9% to 25.1%. The gross profit margin of design integration, equipment manufacturing and delivery system businesses increased by 3.8%, 3.0% and 1.0%, respectively as the company reduced the cost and increased the efficiency through fine management and adjustments of sales structure. However, the company's operating expenses increased a bit faster as the sales expenses grew by 41%, mainly on expansion of the business. The administrative cost grew by 31% due to the increased R&D input, which also dragged down the company's result growth.

### Recovered gross margin



Source: Company report, Phillip Securities (HK) Research

### Buy (Initially)

CMP: HKD 4.62

(Closing price as at 28 Apr 2016)

TARGET: HKD 5.56 (+20.3%)

### COMPANY DATA

O/S SHARES (MN) :	8,790
MARKET CAP (HKDMN) :	40,610
52 - WK HI/LO (HKD):	6.77/3.40

### SHARE HOLDING PATTERN, %

CRSC Group:	75.52
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### PRICE PERFORMANCE, %

	1M	3M	1Y
CRSC	11.32	24.87	-
HSI	6.33	13.59	-

### PRICE VS. HSI



Source: Phillip Securities (HK) Research

### KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	17329	23952	30750	36863
Net Profit	2033	2496	3015	3576
EPS, CNY	0.29	0.32	0.34	0.41
PER, x	13.28	12.03	11.22	9.46
BVPS, CNY	1.67	2.14	2.46	2.82
P/BV, x	2.31	1.80	1.56	1.37
ROE, %	18.79	16.37	14.27	14.84
Debt/Equity (%)	129.1	112.8	122.2	122.2

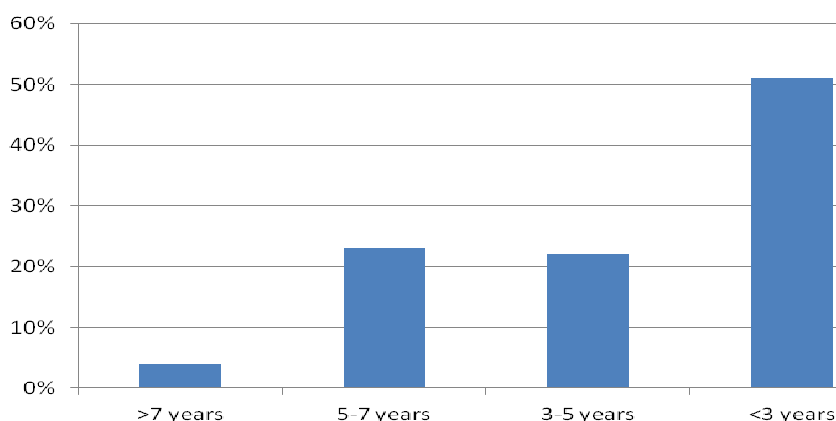
Source: Company reports, Phillip Securities Est.

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## Rapid Outbreak in Urban Rail and Overseas Market

The rapid growth period of railway business has come to past already, and the 12,000 km high-speed railway newly built during the “13th Five-Year Plan” will maintain a normal growth in the railway sector. However, China’s vast rail network will face huge market in terms of system upgrade and operation maintenance. Currently, the high-speed rails running over 7 years account for only 4% of the total operating mileage, but those running for 5 to 7 years take up about 23%. Thus, the revenue from operation and maintenance is expected to rise soon. In general, the railway business is still expected to experience a double-digit growth continuously in the future.

### The breakdown of running years of high-speed rails



Source: Phillip Securities (HK) Research

The company has equipped Line 8 of Beijing Subway with its CBTC system of proprietary intellectual property rights, and will cooperate with CASCO to seek more metro market opportunities. Rapid growth is expected to take place in 2016. Tram market has been rising rapidly with its advantages of low cost, short construction cycle, large capacity and use of clean energy. The estimated annual growth is expected to be 64%. As the leader in control system of this field, the company is expected to take up over 40% of market share. Presently, the company has officially started its construction project cooperated with Tianshui City in PPP mode. In 2015, the company signed new contracts in the field of urban rail transit, worth RMB9.92 billion with a Y-o-Y increase of 209.1%, which will support the rapid growth in coming two years.

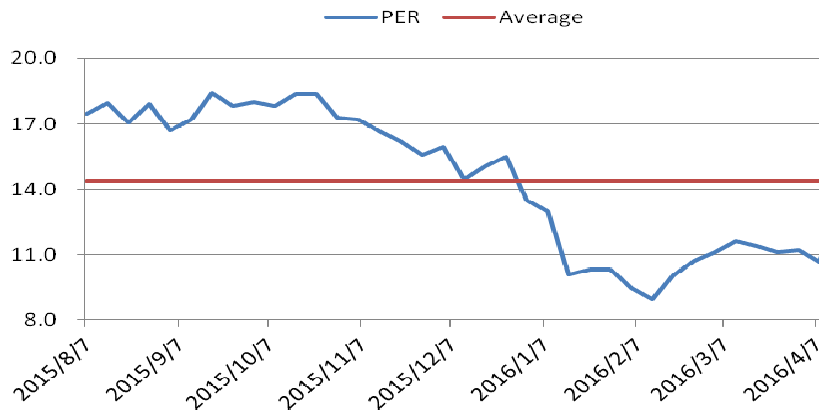
Besides, although the proportion of revenue from overseas market decreased slightly in 2015, the total amount of contracts newly signed increased by 57%. Projects of Indonesia high-speed railway and Mongolia-Inner Mongolia railway will contribute to profits if they both progress smoothly in 2016. The company’s high-speed railway technology connects with European standard seamlessly, which can help its “One Belt, One Road” oversea expansion face a promising prospect.

## Advantage Prominent but Undervalued

With leading technology, oligopoly status, sufficient funds and lower debt ratio, CRSC not only maintains a steady growth in the field of railway, but will also expand rapidly in emerging areas such as PPP. In addition, the company will maintain an explosive growth on urban rail transit market. Meanwhile, the company will continue relying on reducing cost and increasing efficiency, bulk procurement and lean management, thus maintaining the gross profit margin at 25%. Therefore, the company is still

expected to experience a promising prospect in rapid growth. We give an estimation of 13.5x EPS in 2016, and the target price is HKD5.56, with the "Buy" initially. (Closing price as at 28 Apr 2016)

### Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

### Risks

The development of overseas business could not meet expectation.  
Safety accidents break out.

## Financials

Periodicity:	2013	2014	2015	2016F	2017F
<b>Valuation Ratios</b>					
Price Earnings	19.78	13.28	12.03	11.22	9.46
Price to Book	2.70	2.31	1.80	1.56	1.37
Dividend Yield	-	-	0.65%	1.30%	1.56%
<b>Per share data(CNY)</b>					
EPS Adjusted	0.19	0.29	0.32	0.34	0.41
Book Value Per Share	1.43	1.67	2.14	2.46	2.82
Dividends Per Share	-	-	0.03	0.05	0.06
<b>Growth &amp; Margin</b>					
Revenue growth	23.82%	32.64%	38.22%	28.38%	19.88%
Gross profit growth	18.57%	21.96%	43.39%	28.83%	19.88%
Net profit growth	18.06%	61.33%	22.77%	20.78%	18.60%
Gross Margin	26.33%	24.21%	25.11%	25.20%	25.20%
Operating Margin	10.16%	9.87%	10.98%	10.94%	10.91%
Net Profit Margin	9.65%	11.73%	10.42%	9.81%	9.70%
Dividend Payout Ratio %	-	-	8.80%	14.58%	14.75%
<b>Key ratios</b>					
Return on Assets	6.51%	8.10%	7.08%	6.55%	6.68%
Return on Equity	14.34%	18.79%	16.37%	14.27%	14.84%
Liability ratio	53.81%	56.34%	53.00%	55.00%	55.00%
Effective Tax Rate	15.88%	17.51%	16.56%	16.50%	16.50%
<b>Income Statement(CNY: mn)</b>					
<b>Revenue</b>	<b>13,065</b>	<b>17,329</b>	<b>23,952</b>	<b>30,750</b>	<b>36,863</b>
- Cost of Goods Sold	9,625	13,134	17,937	23,001	27,574
<b>Gross Income</b>	<b>3,439</b>	<b>4,195</b>	<b>6,015</b>	<b>7,749</b>	<b>9,290</b>
- Selling, General & Admin Expenses	2,233	2,629	3,588	4,612	5,530
<b>Operating Income</b>	<b>1,327</b>	<b>1,710</b>	<b>2,630</b>	<b>3,364</b>	<b>4,020</b>
Pretax Income	1,473	2,473	3,144	3,794	4,500
- Income Tax Expense	234	433	521	626	743
Income Before XO Items	1,239	2,040	2,623	3,168	3,758
<b>Net Profit</b>	<b>1,260</b>	<b>2,033</b>	<b>2,496</b>	<b>3,015</b>	<b>3,576</b>

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 28 Apr 2016)

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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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