

Shanghai Electric Group Company Limited

1Q 2014 earnings a slight miss

Underweight

2727.HK, 2727 HK

Price: HK\$3.00

▲ **Price Target: HK\$2.40**
Previous: HK\$2.20



- **1Q14 results missed slightly:** Shanghai Electric announced 1Q14 net profit of Rmb670MM (+1% Y/Y). 1Q14 net profit represented ~25% of the full-year consensus number, slightly lower than in 1Q13 (28%). Specifically, the company's gross margin improved to 21.0% in 1Q14 from 18.4% in 1Q13, but was largely offset by the significant surges in tax rate (+35% Y/Y) and minority interests (+37% Y/Y).
- **Orders:** We expect new orders in 1Q14 to exceed 1Q13 levels due to the low base effect (Rmb5B) and possibly reach Rmb12B. The order backlog should remain largely in line with 4Q14 levels (i.e. Rmb237B).
- **Operating CF:** Operating CF remained in negative territory in 1Q14 due to seasonal effects but narrowed to Rmb2.7B in 1Q14 (-29% Y/Y).
- **We raise our PT** from HK\$2.2 to HK\$2.4 as we extend our timeframe from Jun-14 to Dec-14.
- **Maintain UW:** The share price has outperformed the market by ~15% over the past 1-2 months amid market expectations of a potential share price convergence between A-shares/H-shares under the "through-train" ETA. Fundamentally, we remain cautious on demand for coal-fired equipment. The stock is still trading at a demanding valuation, in our view, at 12x 2014E P/E for an ex-growth stock.
- **Analyst conf call** will be held at 9am (HKT) on 30 April 2014 (Wednesday). Dial in numbers: (852) 3005 1380 (HK), 400 678 0218/(010) 5851 1516 (PRC) and (65) 6307 7689 (Sing). Passcode 4030.

China

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Bloomberg JPMA KAN <GO>

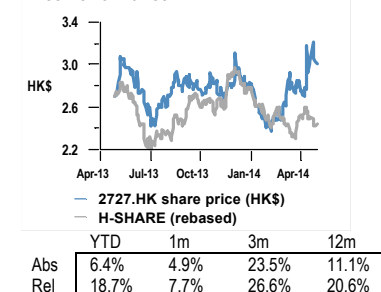
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Price Performance



Shanghai Electric Group Company Limited (Reuters: 2727.HK, Bloomberg: 2727 HK)

Rmb in mn, year-end Dec	FY10A	FY11A	FY12A	FY13A	FY14E
Revenue (Rmb mn)	62,957	71,461	76,591	78,795	80,590
Net Profit (Rmb mn)	2,784	3,183	2,715	2,393	2,605
EPS (Rmb)	0.22	0.25	0.21	0.19	0.20
DPS (Rmb)	0.07	0.07	0.06	0.07	0.08
Revenue growth (%)	9.3%	13.5%	7.2%	2.9%	2.3%
EPS growth (%)	11.7%	13.3%	(14.7%)	(11.8%)	8.9%
ROCE	11.2%	11.6%	11.7%	10.4%	11.0%
ROE	11.3%	11.3%	9.0%	7.6%	7.8%
P/E (x)	11.0	9.7	11.4	13.0	11.9
P/BV (x)	1.1	1.1	1.0	1.0	0.9
Dividend Yield	2.7%	3.1%	2.6%	3.1%	3.4%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Shares O/S (mn)	12,824
Market Cap (Rmb mn)	31,025
Market Cap (\$ mn)	4,962
Price (HK\$)	3.00
Date Of Price	29 Apr 14
Free Float(%)	-
3M - Avg daily vol (mn)	17.12
3M - Avg daily val (HK\$ mn)	48.17
3M - Avg daily val (\$ mn)	6.2
H-SHARE	1,3536.02
Exchange Rate	7.75
Fiscal Year End	Dec

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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Key catalysts for the stock price: <ul style="list-style-type: none"> • Coal-fired power demand • Environmental concerns 	Upside risks to our view: <ul style="list-style-type: none"> • Faster-than-expected resumption of new nuclear project approvals in China • Faster-than-expected growth in overseas markets 	Downside risks to our view: <ul style="list-style-type: none"> • Lower-than-expected ASP for new coal-fired orders • Higher-than-expected losses from heavy machinery business resulting from slower-than-expected economic recovery
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Key financial metrics	FY13E	FY14E	FY15E	FY16E
Revenues (RMB mn)	78,795	80,590	83,589	85,824
Revenue growth (%)	3%	2%	4%	3%
EBITDA (RMB mn)	6,289	6,749	6,959	7,240
EBITDA margin (%)	8%	8%	8%	8%
Tax rate (%)	23%	23%	22%	22%
Net profit (RMB mn)	2,393	2,605	2,647	2,736
EPS (RMB)	0.19	0.20	0.21	0.21
EPS growth (%)	-12%	9%	2%	3%
DPS (RMB)	0.07	0.08	0.08	0.09
BVPS (RMB)	2.51	2.71	2.92	3.13
Operating cash flow (RMB mn)	7,178	7,740	7,757	7,786
Free cash flow (RMB mn)	1,867	6,496	6,630	6,789
Interest cover (x)	19	24	21	22
Net margin (%)	3.0%	3.2%	3.2%	3.2%
Sales/assets (X)	0.6	0.6	0.6	0.6
Debt/equity (%)	12%	11%	11%	10%
Net debt/equity (%)	-54%	-68%	-80%	-91%
ROE (%)	8%	8%	7%	7%
Key model assumptions	FY13E	FY14E	FY15E	FY16E
New energy	5,861	6,685	6,870	7,068
High Efficiency and Clean Energy	32,702	34,613	37,407	38,693
Industrial Equipment	25,301	23,837	23,980	24,883
Modern Services	20,297	20,944	21,025	21,025
Others/Eliminations	(5,366)	(5,489)	(5,693)	(5,845)

Source: Company and J.P. Morgan estimates.

Valuation and price target basis

Our Dec-14 price target of HK\$2.40 is based on 8.6x the four-year forward through-the-cycle EPS, which is one SD below the five-year historical average one-year forward P/E.

JPM vs. consensus, change in estimates

Net profit (Rmb MM)	FY14E	FY15E	FY16E
JPM	2,605	2,647	2,736
Consensus	2,678	2,887	2,842

Source: Bloomberg, J.P. Morgan.

Table 1: Summary of quarterly results under PRC GAAP (after restatement)

Rmb MM	1Q12 (restated)	2Q12 (restated)	3Q12 (restated)	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	Y/Y
Sales	17,190	21,490	18,033	22,100	16,980	21,585	17,930	22,719	15,725	(7)
COS	(13,877)	(17,288)	(14,181)	(18,202)	(13,862)	(17,755)	(14,401)	(18,248)	(12,430)	(10)
Gross profit	3,313	4,203	3,852	3,898	3,118	3,830	3,529	4,471	3,294	6
Gross margin %	19.3	19.6	21.4	17.6	18.4	17.7	19.7	19.7	21.0	2.6
Operating expenses	(1,853)	(2,499)	(2,374)	(3,029)	(2,060)	(2,471)	(2,354)	(3,338)	(2,121)	3
Operating expenses as % of sales	10.8	11.6	13.2	13.7	12.1	11.4	13.1	14.7	13.5	1.4
Operating profit (EBIT)	1,460	1,704	1,479	869	1,058	1,359	1,176	1,133	1,173	11
EBIT %	8.5	7.9	8.2	3.9	6.2	6.3	6.6	5.0	7.5	1.2
Share of associates / JCE	283	255	173	87	245	82	152	382	253	3
Others operating gain (losses), net	(210)	(526)	54	(324)	(166)	(182)	16	(916)	(165)	(1)
Others non-operating gain (losses), net	79	148	167	314	110	359	222	494	117	7
Finance income (expenses), net	(68)	69	(25)	51	(46)	15	(14)	17	19	(141)
Profit before tax	1,544	1,650	1,847	997	1,200	1,634	1,552	1,111	1,397	16
Tax	(275)	(254)	(319)	(569)	(276)	(332)	(326)	(139)	(371)	35
Minority interest	(355)	(436)	(487)	(576)	(260)	(507)	(596)	(599)	(356)	37
Net profit - reported	914	959	1,041	(148)	665	795	630	373	670	1
EPS - reported	0.07	0.07	0.08	(0.01)	0.05	0.06	0.05	0.03	0.05	1

Source: Company data

Table 2: Quarterly operating cash flow after restatement

Rmb MM	2011	2012	2013	2014
1Q	(3,552)	(4,291)	(3,789)	(2,704)
2Q	189	3,353	4,822	
3Q	390	(1,226)	1,650	
4Q	3,247	8,878	4,494	
Total	275	6,672	7,178	

Source: Company data

Investment Thesis, Valuation and Risks

Shanghai Electric Group Company Limited *(Underweight; Price Target: HK\$2.40)*

Investment Thesis

Shanghai Electric is one of the largest equipment manufacturing conglomerates in China, with high-efficiency and clean energy as well as new energy equipment, which represents its core business segments. Our bearish view on Shanghai Electric rests on the expected weak demand for coal-fired equipment as China: 1) relies less and less on coal due to pollution concerns, and 2) has slower power demand growth going forward as the nation shifts away from an FAI growth model.

Valuation

The stock is trading at 11x /11x 2014E/15E P/E, the highest among listed peers, and 0.8x/0.7x 2014E/15E P/BV.

Our Dec-14 price target of HK\$2.40 is based on 8.6x the four-year forward 'through-the-cycle' EPS in 2013-15E, which is one SD below the five-year historical average one-year forward P/E. Our PT is equivalent to 9x/9x 2014E/15E P/E.

Risks to Rating and Price Target

Upside risks to our UW rating and PT include: higher-than-expected margins on coal-fired units as management creates more production cost savings through: 1) internal cost control, and 2) lower procurement costs from suppliers.

Shanghai Electric Group Company Limited: Summary of Financials

Income Statement					Cash flow statement				
Rmb in millions, year end Dec	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY13	FY14E	FY15E	FY16E
Revenues	78,795	80,590	83,589	-	EBIT	4,725	5,154	5,284	-
% change Y/Y	2.9%	2.3%	3.7%	-	- Depr. & amortization	1,564	1,595	1,675	-
Gross Margin	17.4%	17.4%	17.1%	-	- Change in working capital	739	2,725	2,677	-
EBITDA	6,289	6,749	6,959	-	- Taxes	(1,545)	(1,168)	(1,186)	-
% change Y/Y	(7.7%)	7.3%	3.1%	-	- Others	(407)	(2,331)	(2,437)	-
EBITDA margin	8.0%	8.4%	8.3%	-	- Cash flow from operations	7,178	7,740	7,757	-
EBIT	4,725	5,154	5,284	-	- Capex	(1,445)	(1,810)	(1,821)	-
% change Y/Y	(11.0%)	9.1%	2.5%	-	- Disposal/(purchase)	326	0	0	-
EBIT Margin	6.0%	6.4%	6.3%	-	- Cash outflow on investing activities	(5,311)	(1,244)	(1,127)	-
Net Interest	(254)	(215)	(254)	-	- Free cash flow	5,935	6,101	6,138	-
Earnings before tax	5,283	5,751	5,841	-	- Equity raised/(repaid)	0	0	0	-
% change Y/Y	(7.7%)	8.9%	1.6%	-	- Debt raised/(repaid)	(1,476)	0	0	-
Tax	(1,073)	(1,168)	(1,186)	-	- Dividends paid	-	-	-	-
as % of EBT	20.3%	20.3%	20.3%	-	- Other	37	(215)	(254)	-
Net income (reported)	2,393	2,605	2,646	-	- Cash flow from financing act.	(1,439)	(215)	(254)	-
% change Y/Y	(11.8%)	8.9%	1.6%	-	- Increase (decrease) in cash	428	6,281	6,375	-
Shares outstanding	12,824	12,824	12,824	-	- Beginning cash	-	-	-	-
EPS (reported)	0.19	0.20	0.21	-	- Ending cash	22,023	28,305	34,679	-
% change Y/Y	(11.8%)	8.9%	1.6%	-	- DPS	0.07	0.08	0.08	-
Balance sheet					Ratio Analysis				
Rmb in millions, year end Dec	FY13	FY14E	FY15E	FY16E	Rmb in millions, year end Dec	FY13	FY14E	FY15E	FY16E
Inventories	20,645	20,011	20,069	-	- EBITDA margin	8.0%	8.4%	8.3%	-
Trade debtors	36,127	36,288	36,951	-	- Net profit margin	3.0%	3.2%	3.2%	-
Bank balances and cash	22,023	28,305	34,679	-	-	-	-	-	-
Other current assets	22,675	22,675	21,430	-	- Sales growth	2.9%	2.3%	3.7%	-
Current assets	101,471	107,279	113,130	-	- Net profit growth	(11.8%)	8.9%	1.6%	-
Net fixed assets	16,848	17,064	17,210	-	- EPS growth	(11.8%)	8.9%	1.6%	-
Other non-current assets	-	-	-	-	-	-	-	-	-
Total Assets	129,293	136,128	142,937	-	- Net debt to total capital	(73.1%)	(105.9%)	(144.5%)	-
Liabilities	-	-	-	-	- Net debt to equity	(42.2%)	(51.4%)	(59.1%)	-
Short-term loans	3,765	3,765	3,765	-	- Sales/assets	0.6	0.6	0.6	-
Payables	29,243	31,014	33,084	-	- Assets/equity	4.0	4.0	3.9	3.8
Others	49,229	49,710	49,794	-	- ROE	7.6%	7.8%	7.3%	-
Total current liabilities	82,237	84,488	86,642	-	- ROCE	10.4%	11.0%	10.5%	-
Long-term debt	218	218	218	-	-	-	-	-	-
Other liabilities	4,130	4,130	4,130	-	-	-	-	-	-
Total Liabilities	86,584	88,836	90,990	-	-	-	-	-	-
Shareholders' equity	32,206	34,811	37,458	-	-	-	-	-	-
BVPS	2.51	2.71	2.92	-	-	-	-	-	-

Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile

Shanghai Electric Group Co., Ltd. Class H (CHINA / Industrials)

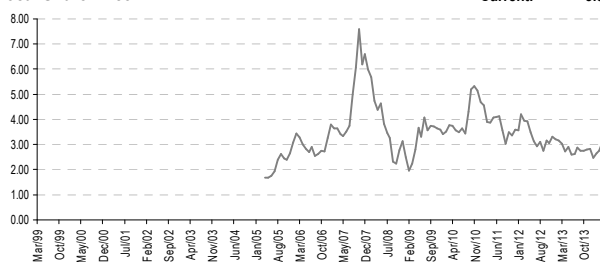
As Of: 25-Apr-2014

Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

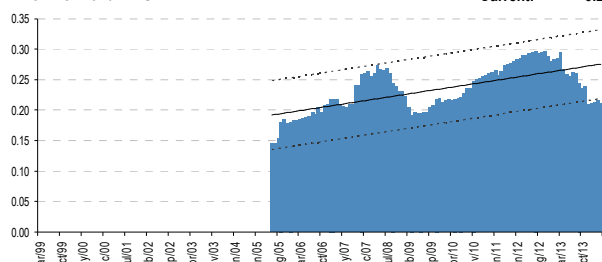
Local Share Price

Current: 3.09



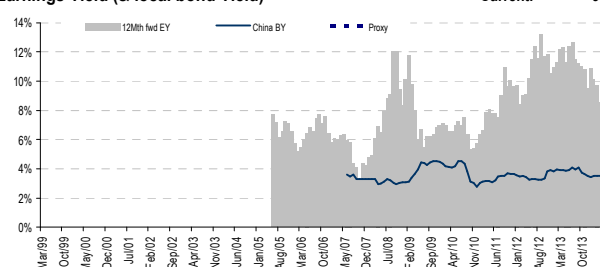
12 Mth Forward EPS

Current: 0.21



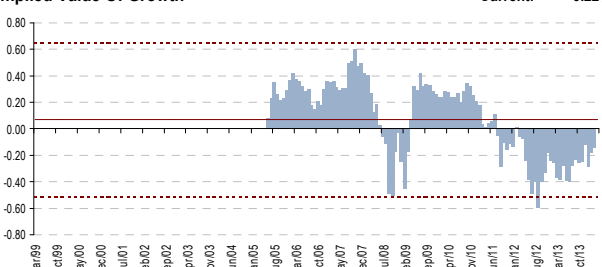
Earnings Yield (& local bond Yield)

Current: 9%



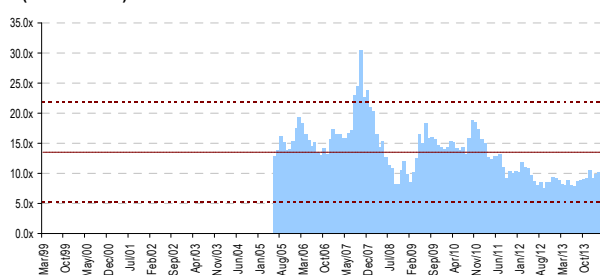
Implied Value Of Growth*

Current: 0.22%



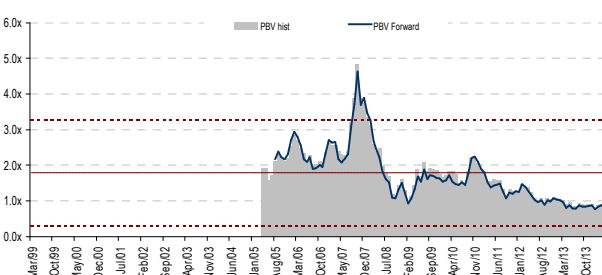
PE (1Yr Forward)

Current: 11.8x



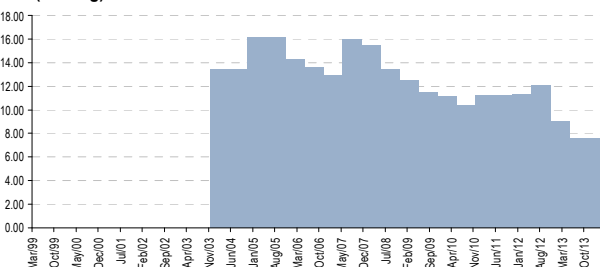
Price/Book Value

Current: 1.0x



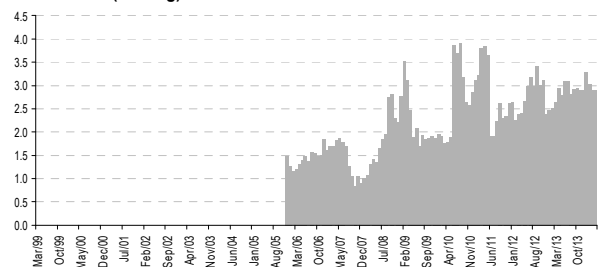
ROE (Trailing)

Current: 7.36



Dividend Yield (Trailing)

Current: 2.89



Summary

Shanghai Electric Group Co., Ltd. Class H		SEDOL		B07J656		As Of:		25-Apr-14	
CHINA						Local Price:		3.09	
Industrials						EPS:		0.21	
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max
12mth Forward PE	11.76x	7.58	30.45	13.49	13.55	21.89	5.20	-36%	159%
P/BV (Trailing)	1.03x	0.80	4.85	1.72	1.80	3.28	0.31	-22%	371%
Dividend Yield (Trailing)	2.89	0.00	3.90	1.97	2.11	4.01	0.20	-100%	35%
ROE (Trailing)	7.36	7.36	16.17	12.48	12.44	17.34	7.55	0%	120%
Implied Value of Growth	0.2%	-0.60	0.60	0.18	0.07	0.65	-0.51	-27007%	27098%
								8098%	3080%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

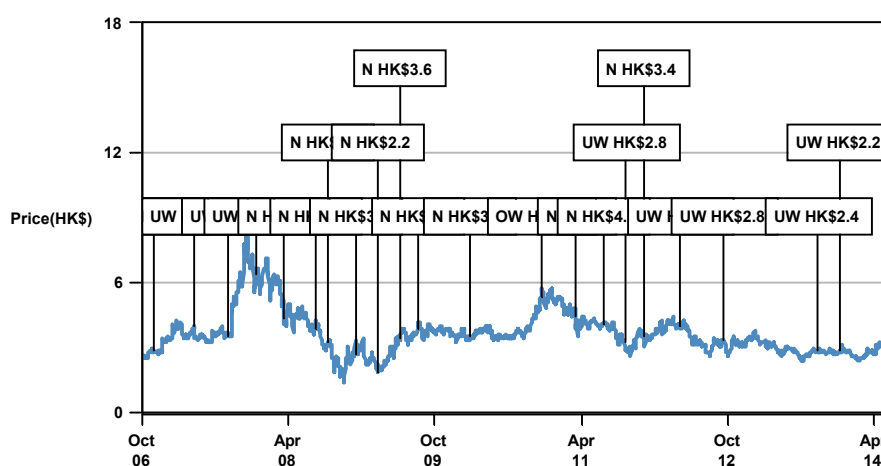
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Shanghai Electric Group Company Limited (2727.HK, 2727 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Nov 17, 2006.

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
17-Nov-06	UW	2.83	2.50
16-Apr-07	UW	3.96	2.60
20-Aug-07	UW	3.51	3.00
04-Dec-07	UW	6.35	4.80
16-Mar-08	N	4.30	4.20
16-Jul-08	N	3.92	4.30
24-Aug-08	N	3.19	3.80
12-Dec-08	N	2.64	3.10
01-Mar-09	N	1.87	2.20
22-May-09	N	3.38	3.60
26-Jul-09	N	3.89	3.90
12-Feb-10	N	3.50	3.80
02-Nov-10	OW	5.31	6.60
13-Mar-11	N	4.46	5.00
25-Jun-11	N	4.04	4.20
12-Sep-11	UW	3.20	2.80
22-Nov-11	N	3.51	3.40
05-Apr-12	UW	3.94	3.30
16-Sep-12	UW	3.32	2.80
02-Sep-13	UW	2.87	2.40
24-Nov-13	UW	2.82	2.20

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

Explanation of Equity Research Ratings, Designations and Analyst(s) Coverage Universe:

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Coverage Universe: Kan, Boris: Beijing Enterprises Holdings Limited (0392.HK), China Gas Holdings Limited (0384.HK), China High Speed Transmission (0658.HK), China Longyuan Power Group Corp. (0916.HK), China Power International (2380.HK), China Resources Gas Group Limited (1193.HK), China Resources Power Holdings (0836.HK), Datang International (0991.HK), Dongfang Electric Corporation Limited - H (1072.HK), ENN Energy Holdings Limited (2688.HK), Harbin Electric Company Limited (1133.HK), Huaneng Power Int'l - H (0902.HK), Kunlun Energy Company Limited (0135.HK), Shanghai Electric Group Company Limited (2727.HK), Towngas China Company Limited (1083.HK), Xinjiang Goldwind Science & Technology Co., Ltd. (2208.HK)

J.P. Morgan Equity Research Ratings Distribution, as of March 31, 2014

	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	44%	44%	11%
IB clients*	58%	49%	40%
JPMS Equity Research Coverage	45%	48%	7%
IB clients*	78%	67%	60%

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