



Rating
Buy

Asia
China

Industrials
Manufacturing

Company
**Shenzhen Inovance
Technology Co.,
Ltd.**

Reuters 300124.SZ Bloomberg 300124 CH Exchange SHZ Ticker 300124

Date
28 August 2017

Results

Price at 25 Aug 2017 (CNY)	25.71
Price target - 12mth (CNY)	30.10
52-week range (CNY)	26.43 - 18.20
Shenzhen Index	1,998

Passenger NEV – higher opex but nice progress; reiterating Buy

IA ahead of expectations; passenger NEV has started to make progress

Inovance's 1H result (NP up 10% YoY) tracks behind our full-year estimates, dragged by surging opex associated with the passenger NEV business. However, underlying operations and management's comments at the analyst call brought up two positive surprises: 1) stronger-than-expected IA growth in 1H and sustainable 30-50% growth guided by management going forward, and 2) an encouraging breakthrough in the passenger NEV business with 6-7 customers secured in 1H. With continuing strength in IA, an NEV bus recovery, opex normalization and rising contributions from passenger NEV and industrial robots, we believe earnings growth is set to accelerate. We maintain Buy.

Strong 1H top-line growth partially offset by margin contraction

1H net profit of Rmb429m (+10% YoY) achieved 36% of our full-year estimate, which tracks behind the 5-year average of 43%. GP margin contracted 3.3ppt to 45.8%, driven mainly by the new energy segment (down 18.2ppt YoY). This, along with higher-than-expected opex (R&D expense +75% YoY and selling expense +41% YoY), partially offset strong top-line growth in 1H (+32% YoY). In 2Q alone, sales growth moderated to 29% YoY from 38% YoY in 1Q, while NP growth visibly slowed to 3% YoY (from 24% YoY in 1Q), largely due to surging opex.

Stronger-than-expected IA growth a key positive

Sales of general IA products (servos and inverters) soared 90%+ YoY in 1H, way ahead of China's overall market growth (15% for inverters and 23 % for servos in 1H), management's full-year guidance (30-50%) and our full-year estimates (50-60%). Inovance's "vertical-based" strategy continued to facilitate its market gains in traditional verticals like textile machinery and air compressors.

GPM contracted while opex surged

GPM contraction was mainly because of 1) ASP cuts (10-20% by Yutong), low sales volume and higher sales rebates in the NEV segment and 2) an unfavorable product mix in the inverter segment (i.e. rising contributions from low-margin auxiliary elevator products and high-voltage inverters). The big jump in opex was mainly due to a passenger NEV business expansion, with the R&D expense ratio (as a percentage of sales) rising to a historical high of 14% in 1H. Such a surge, however, is likely to be a one-time event as management expects the ratio to normalize to 8-10% starting in 2018.

Guidance by segment is upbeat; encouraging breakthrough on new businesses

Valuation & Risks

Sky Hong, CFA

Research Analyst
+852-2203 6131

Nick Zheng, CFA

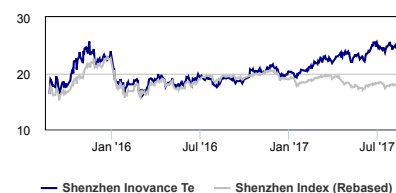
Research Analyst
+852-2203 6198

Key changes

Sales (FYE)	4,865 to 4,989	↑	2.5%
Op prof margin (FYE)	27.8 to 24.1	↓	-13.2%
Net profit (FYE)	1,196.5 to 1,066.8	↓	-10.8%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.2	12.3	32.9
Shenzhen Index	3.3	5.4	-5.4

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	21.3
Net debt/equity (%)	-33.1
Book value/share (CNY)	3.20
Price/book (x)	8.0
Net interest cover (x)	-
Operating profit margin (%)	24.1

Source: Deutsche Bank



At Friday's post-result conference call, management gave an update of the latest progress in new business development and provided guidance segment by segment.

- General IA products to sustain high growth:** New order growth, albeit slower on tougher comps, managed to sustain its high level in July (50%+ YoY). Looking ahead, management expects its general inverter and controller business to sustain 30%+ growth while general servo sales keeps growing at a pace of 50%+, as Inovance views automation upgrades as a secular growth driver of the segment.
- NEV segment to be back on track in 2H:** Despite headwinds from Yutong in 1H, logistics NEV and non-Yutong NEV bus businesses were on track to achieve the full-year target. New orders from Yutong in June and July have already shown a visible recovery (a 50%+ YoY increase). Management retains its full-year guidance of >30% for the segment (DBe: 30%).
- Heavy investment in passenger NEV has started to show progress:** Being the first local player to successfully roll out automated production lines and obtain the ISO26262 certification (the highest safety standard for auto electronic systems) for the passenger NEV drive, Inovance managed to secure 5-6 tier-2 passenger NEV customers to supply its controller products and 1 customer for its powertrain products. Management is confident that they can secure 1-2 tier-1 passenger NEV customers in 2H17 and expects the business to take off in 2019. In the longer term, management expects third-party OEMs to take a bigger share of China's passenger NEV powertrain market. Inovance is likely to stand out in terms of cost competitiveness, technology and quality control.
- Industrial robotics to emerge as a new growth driver in long term:** In 1H, Inovance successfully expanded its robot product offering. Its new products are also massively being tested by customers in verticals like mobile phone manufacturing and lithium batteries.

Maintaining Buy; risks

We cut our 2017 earnings estimate by 11% after modeling in stronger-than-expected IA growth in 1H (lifting revenue by 3%) but more conservative opex assumptions. We keep our 2018-19 forecasts largely unchanged and retain our DCF-based target price of Rmb30.1 (WACC:8% and TGR: 2%). Key risks: slower-than-expected NEV growth and an IA demand recovery.

Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	2,770.5	3,660.0	4,988.7	6,516.2	8,350.2
EBITDA (CNYm)	912.0	1,140.8	1,316.9	1,883.6	2,428.1
Reported NPAT (CNYm)	809.3	931.8	1,066.8	1,534.2	1,974.2
DB EPS FD(CNY)	0.51	0.58	0.64	0.92	1.19
OLD DB EPS FD(CNY)	0.51	0.58	0.72	0.94	1.19
% Change	0.0%	0.0%	-10.8%	-2.3%	-0.1%
DB EPS growth (%)	20.1	13.1	10.5	43.8	28.7
DPS (net) (CNY)	0.50	0.28	0.31	0.45	0.58
Yield (net) (%)	2.3	1.5	1.2	1.8	2.3

Source: Deutsche Bank estimates, company data



Model updated: 27 August 2017

Running the numbers

Asia

China

Manufacturing

Shenzhen Inovance Technolog

Reuters: 300124.SZ Bloomberg: 300124 CH

Buy

Price (25 Aug 17) CNY 25.71

Target Price CNY 30.10

52 Week range CNY 18.20 - 26.43

Market cap (m) CNYm 42,810
USDm 6,423.3

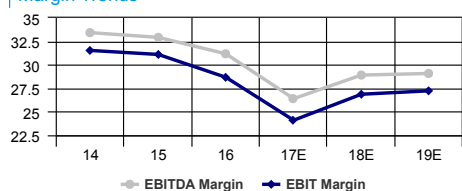
Company Profile

Founded in 2003, Shenzhen Inovance mainly focuses on R&D, manufacture and sales of industrial automation products. The company's product portfolio includes low-voltage inverters, servo systems, PLCs, HMIs, specialized control & drive system for elevators, new energy vehicle controllers and traction & control system for rail.

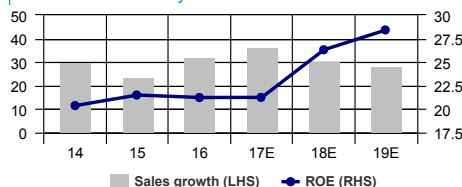
Price Performance



Margin Trends



Growth & Profitability



Sky Hong, CFA

+852 2203 6131

sky.hong@db.com

Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.43	0.51	0.58	0.64	0.92	1.19
Reported EPS (CNY)	0.43	0.51	0.58	0.64	0.92	1.19
DPS (CNY)	0.50	0.50	0.28	0.31	0.45	0.58
BVPS (CNY)	4.4	5.1	2.9	3.2	3.8	4.5
Weighted average shares (m)	1,560	1,578	1,579	1,665	1,665	1,665
Average market cap (CNYm)	22,933	34,216	29,913	42,810	42,810	42,810
Enterprise value (CNYm)	21,271	33,051	28,382	41,038	40,302	39,388

Valuation Metrics

P/E (DB) (x)	34.4	42.3	32.7	40.1	27.9	21.7
P/E (Reported) (x)	34.4	42.3	32.7	40.1	27.9	21.7
P/BV (x)	3.21	4.56	6.94	8.04	6.76	5.67
FCF Yield (%)	1.7	1.7	0.9	1.7	3.0	3.9
Dividend Yield (%)	3.4	2.3	1.5	1.2	1.8	2.3
EV/Sales (x)	9.5	11.9	7.8	8.2	6.2	4.7
EV/EBITDA (x)	28.4	36.2	24.9	31.2	21.4	16.2
EV/EBIT (x)	30.1	38.4	27.1	34.1	23.0	17.3

Income Statement (CNYm)

Sales revenue	2,243	2,771	3,660	4,989	6,516	8,350
Gross profit	1,127	1,343	1,761	2,336	3,081	3,920
EBITDA	749	912	1,141	1,317	1,884	2,428
Depreciation	26	32	59	69	81	93
Amortisation	16	19	32	45	52	61
EBIT	707	862	1,049	1,202	1,751	2,274
Net interest income/(expense)	69	45	11	32	45	63
Associates/affiliates	-1	-1	-14	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	-2	0	0	0
Profit before tax	775	905	1,044	1,235	1,796	2,337
Income tax expense	85	71	63	123	198	280
Minorities	24	25	48	44	64	82
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	666	809	932	1,067	1,534	1,974
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	666	809	932	1,067	1,534	1,974

Cash Flow (CNYm)

Cash flow from operations	524	802	420	961	1,536	1,953
Net Capex	-127	-207	-136	-250	-258	-265
Free cash flow	397	594	284	711	1,278	1,687
Equity raised/(bought back)	77	190	584	0	0	0
Dividends paid	-401	-411	-415	-458	-524	-754
Net inc/(dec) in borrowings	0	-5	91	-117	0	-2
Other investing/financing cash flows	63	-495	173	32	45	63
Net cash flow	137	-127	717	169	799	994
Change in working capital	-148	-30	-631	-232	-150	-195

Balance Sheet (CNYm)

Cash and other liquid assets	1,836	1,408	1,708	1,877	2,676	3,670
Tangible fixed assets	455	595	646	727	803	875
Goodwill/intangible assets	157	459	599	659	708	748
Associates/investments	4	3	218	218	218	218
Other assets	2,220	3,483	4,803	5,897	6,989	8,378
Total assets	4,671	5,947	7,974	9,377	11,394	13,889
Interest bearing debt	0	15	128	11	11	9
Other liabilities	1,025	1,642	2,863	3,730	4,673	5,868
Total liabilities	1,025	1,657	2,992	3,741	4,684	5,877
Shareholders' equity	3,468	4,060	4,716	5,325	6,335	7,555
Minorities	178	230	267	311	375	457
Total shareholders' equity	3,646	4,290	4,982	5,636	6,710	8,012
Net debt	-1,836	-1,393	-1,580	-1,866	-2,665	-3,661

Key Company Metrics

Sales growth (%)	29.9	23.5	32.1	36.3	30.6	28.1
DB EPS growth (%)	18.2	20.1	13.1	10.5	43.8	28.7
EBITDA Margin (%)	33.4	32.9	31.2	26.4	28.9	29.1
EBIT Margin (%)	31.5	31.1	28.7	24.1	26.9	27.2
Payout ratio (%)	117.0	97.5	48.2	49.1	49.1	49.1
ROE (%)	20.4	21.5	21.2	21.3	26.3	28.4
Capex/sales (%)	5.7	7.5	3.7	5.0	4.0	3.2
Capex/depreciation (x)	3.0	4.1	1.5	2.2	1.9	1.7
Net debt/equity (%)	-50.3	-32.5	-31.7	-33.1	-39.7	-45.7
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Shenzhen Inovance Technology Co., Ltd.	300124.SZ	25.71 (CNY) 25 Aug 2017	NA

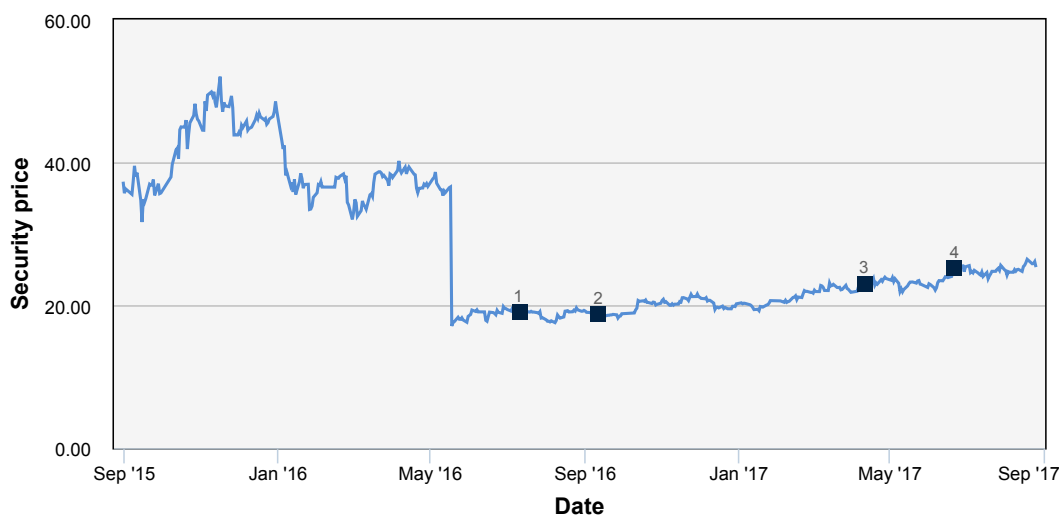
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Historical recommendations and target price. Shenzhen Inovance Technology Co., Ltd. (300124.SZ)

(as of 08/25/2017)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	07/11/2016	Buy, Target Price Change CNY 23,20 Sky Hong, CFA	3.	04/12/2017	Buy, Target Price Change CNY 26,50 Sky Hong, CFA
2.	09/12/2016	Buy, Target Price Change CNY 26,80 Sky Hong, CFA	4.	06/22/2017	Buy, Target Price Change CNY 30,10 Sky Hong, CFA



Equity Rating Key

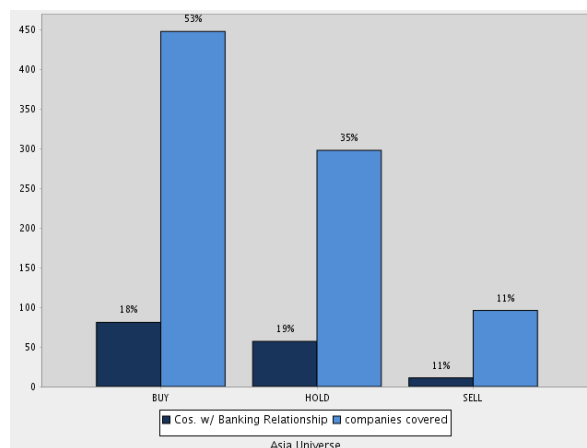
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Paul Reynolds
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Pam Finelli
Global Head of
Equity Derivatives Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500
