



Rating  
**Buy**

Asia  
China

Technology  
Hardware & Equipment

Company  
**Kstar**

Reuters 002518.SZ    Bloomberg 002518 CH    Exchange SHZ    Ticker 002518

Date  
28 September 2017

## Forecast Change

Price at 28 Sep 2017 (CNY)	17.59
Price target - 12mth (CNY)	18.60
52-week range (CNY)	22.98 - 13.15
Shenzhen Index	2,070

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# SZ factory visit: ongoing UPS market share expansion

## Local UPS king is gaining its power over international peers in China

We visited Kstar's SZ UPS factory. The company is upbeat on its UPS market share expansion in both China (especially on 20kVA+ UPS) and overseas, thanks to its high precision and cost/performance products. We feel comfortable with its 20%+ online UPS sales CAGR in 2017-2020E and 38-40% GPM thanks to favorable product mix change (integrated/higher power UPS). We also believe international UPS brands (Riello, Schneider, Emerson) will accelerate their outsourcing to qualified ODMs like Voltronic, given rising competition from local kings. Voltronic and Kstar are our top picks in Greater China UPS fields; we reiterate our Buy ratings on both names.

## Upbeat 2017 outlook driven by online UPS/inverter strength

Kstar is upbeat on its 2017 outlook and targets a 30%+ earnings CAGR in 2017-2019E driven by online UPS and inverter strength. Propelled by continued inverter order wins for the Chinese government's poverty reduction projects in rural areas, Kstar expects a 100% YoY inverter revenue increase this year, with GPM ramping to 35-36% vs. 30-33% before. For UPS, Kstar expects continued market share expansion in 20kVA+ orders thanks to its R&D strength and promotion from the Chinese government. Kstar is also offering an integrated UPS solution (battery + UPS + high-precision air conditioner) to China's IDC, helping drive potential 20%+ online UPS revenue CAGR in the next three years.

## Kstar's ongoing UPS gain implies rising pressure on international competitors

Kstar expects its Chinese UPS market share to ramp up to 20-22% in two years' time, vs. 15-16% currently. Management attributes the faster expansion to its take-off in 20kVA+ UPS. By leveraging its good relationship with local government (in high-speed railway/governmental projects) and high cost/performance products (10-15% lower price vs. international competitors), Kstar continues to gain market share from international peers (e.g. Schneider, Emerson) in China. Besides the domestic market, Kstar is promoting its own-brand products in emerging countries (e.g. South East Asia) by setting up 10 branches overseas. The company believes its good customization capabilities in small-power UPS manufacturing will help it outperform international brands in emerging countries (lack of power standard) going forward.

## Valuation and risks

We raise our 2017 EPS estimate by 12% to factor in stronger UPS/inverter demand. We lift our TP to RMB18.6 from RMB16.4 as we roll over to one year FW EPS vs. 2017E EPS before (still based on 30x 2017E P/E, or 1.0x PEG). Risks: weaker China UPS demand, price competition, and unfavorable FX.

## Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E
Sales (CNYm)	1,514	1,726	2,632	3,287
Reported NPAT (CNYm)	233	296	393	506
Reported EPS FD(CNY)	0.41	0.48	0.64	0.82
OLD DB EPS FD(CNY)	0.41	0.48	0.57	0.83

Source: Deutsche Bank estimates, company data

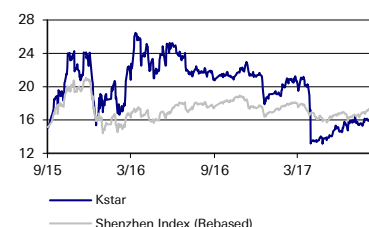
<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

## Key changes

TP	16.40 to 18.60	↑	13.4%
Sales (FYE)	2,093 to 2,632	↑	25.8%
Op prof margin (FYE)	16.6 to 15.1	↓	-9.0%
Net profit (FYE)	349.9 to 393.0	↑	12.3%

Source: Deutsche Bank

## Price/price relative



Performance (%)	1m	3m	12m
Absolute	7.4	18.3	-16.7
Shenzhen Index	2.2	5.1	0.0

Source: Deutsche Bank

## Key indicators (FY1)

ROE (%)	18.1
Net debt/equity (%)	-36.0
Book value/share (CNY)	3.84
Price/book (x)	4.58
Net interest cover (x)	-
Operating profit margin (%)	15.1

Source: Deutsche Bank



Model updated: 28 September 2017

Running the numbers

Asia  
 China  
 Hardware & Equipment

Kstar

Reuters: 002518.SZ Bloomberg: 002518 CH

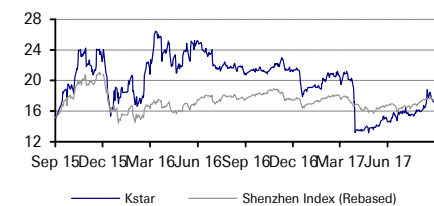
Buy

Price (28 Sep 17) CNY 17.59  
 Target Price CNY 18.60  
 52 Week range CNY 13.15 - 22.98  
 Market Cap (m) CNYm 10,135  
 USDm 1,527

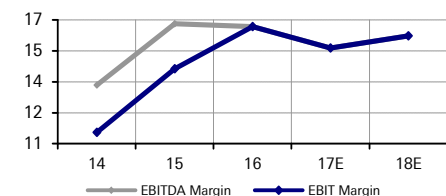
Company Profile

Established in 1993 and listed in Shenzhen in 2010, Kstar is the largest uninterruptible power supply (UPS) brand in China with a 15% market share. The company's product portfolio consists of UPS, lead-acid storage batteries, solar inverters, and other electrical and electronic products. By leveraging its high-quality/power UPS, Kstar has established long-term solid partnerships with leading Chinese financial institutions (ICBC, China Life) and telecom operators (China Mobile, China Telecom).

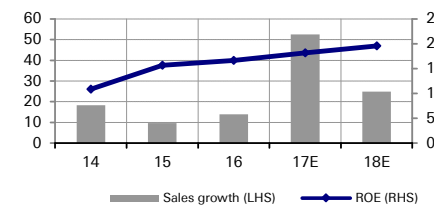
Price Performance



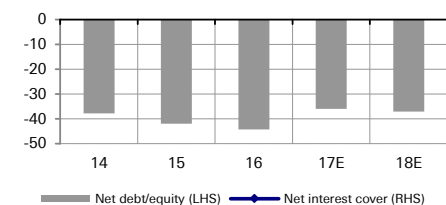
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E
DB EPS (CNY)	0.26	0.41	0.48	0.64	0.82
Reported EPS (CNY)	0.26	0.41	0.48	0.64	0.82
DPS (CNY)	0.04	0.07	0.00	0.08	0.10
BVPS (CNY)	2.4	2.8	5.1	3.8	4.6
Weighted average shares (m)	579	572	615	615	615
Average market cap (CNYm)	7,054	10,107	13,351	10,135	10,135
Enterprise value (CNYm)	6,369	9,260	12,462	9,268	9,078

Valuation Metrics

P/E (DB) (x)	46.2	43.3	45.1	27.5	21.4
P/E (Reported) (x)	46.2	43.3	45.1	27.5	21.4
P/BV (x)	4.39	8.47	4.17	4.58	3.85
FCF Yield (%)	2.7	1.9	nm	nm	2.4
Dividend Yield (%)	0.3	0.4	0.0	0.4	0.6
EV/Sales (x)	4.6	6.1	7.2	3.5	2.8
EV/EBITDA (x)	34.6	37.5	44.6	23.3	17.6
EV/EBIT (x)	41.8	43.3	44.6	23.3	17.6

Income Statement (CNYm)

Sales revenue	1,380	1,514	1,726	2,632	3,287
Gross profit	446	540	620	909	1,141
EBITDA	184	247	279	399	517
Depreciation	29	31	0	0	0
Amortisation	2	2	0	0	0
EBIT	152	214	279	399	517
Net interest income/(expense)	2	4	0	0	0
Associates/affiliates	-16	-29	0	-5	-5
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	37	80	55	71	80
Profit before tax	175	269	335	465	592
Income tax expense	24	39	35	67	82
Minorities	-1	-3	4	4	4
Other post-tax income/(expense)	0	0	0	0	0
Net profit	153	233	296	393	506
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	153	233	296	393	506

Cash Flow (CNYm)

Cash flow from operations	223	229	-27	183	306
Net Capex	-36	-38	-40	-200	-50
Free cash flow	188	192	-68	-17	256
Equity raised/(bought back)	0	0	0	0	0
Dividends paid	-45	-74	0	0	-61
Net inc/(dec) in borrowings	32	36	-44	21	16
Other investing/financing cash flows	-237	24	274	-6	-6
Net cash flow	-62	177	162	-2	206
Change in working capital	23	-66	-323	-215	-204

Balance Sheet (CNYm)

Cash and other liquid assets	684	862	1,023	1,021	1,227
Tangible fixed assets	337	325	427	627	677
Goodwill/intangible assets	0	0	0	12	36
Associates/investments	172	196	33	34	35
Other assets	792	988	1,110	1,562	1,973
Total assets	1,985	2,370	2,593	3,256	3,947
Interest bearing debt	149	185	140	161	177
Other liabilities	420	571	456	705	936
Total liabilities	569	755	596	866	1,113
Shareholders' equity	1,393	1,589	1,970	2,363	2,807
Minorities	23	26	26	27	27
Total shareholders' equity	1,416	1,615	1,997	2,390	2,834
Net debt	-536	-677	-883	-860	-1,049

Key Company Metrics

Sales growth (%)	18.4	9.7	13.9	52.5	24.9
DB EPS growth (%)	18.2	54.9	17.9	32.8	28.6
EBITDA Margin (%)	13.3	16.3	16.2	15.1	15.7
EBIT Margin (%)	11.0	14.1	16.2	15.1	15.7
Payout ratio (%)	15.0	16.3	0.0	12.0	12.0
ROE (%)	10.9	15.7	16.6	18.1	19.6
Capex/sales (%)	2.6	2.5	2.3	7.6	1.5
Capex/depreciation (x)	1.1	1.1	nm	nm	nm
Net debt/equity (%)	-37.8	-41.9	-44.2	-36.0	-37.0
Net interest cover (x)	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates



# P&L highlight

Buy rating with a 12-month target price of RMB18.6

Figure 1: Quarterly P&L highlights

(RMB mn)	1Q17	2Q17	3Q17E	4Q17E	2017E	1Q18E	2Q18E	3Q18E	4Q18E	2018E
Sales	398	677	737	820	2,632	582	704	905	1,096	3,287
Gross profit	137	230	254	288	909	190	234	319	398	1,141
Operating profit	60	124	137	78	399	44	87	157	229	517
Non-operating item	-4	-14	13	71	66	19	19	19	19	75
Pre-tax income	55	110	150	149	465	62	106	176	248	592
Net profit	50	99	126	118	393	55	85	155	212	506
EPS (RMB)	0.08	0.16	0.20	0.19	0.64	0.09	0.14	0.25	0.34	0.82
No. of shares (m)	615.1	615.1	615.1	615.1	615.1	615.1	615.1	615.1	615.1	615.1
<b>Margin Analysis (%)</b>										
Gross margin	34.5	33.9	34.5	35.1	34.5	32.7	33.2	35.3	36.3	34.7
Operating margin	15.0	18.3	18.5	9.5	15.1	7.5	12.3	17.3	20.9	15.7
Pre-tax margin	13.9	16.3	20.3	18.2	17.6	10.7	15.0	19.4	22.7	18.0
Tax rate	10.1	10.2	16.0	20.6	15.4	12.0	20.0	12.0	14.8	14.6
<b>YoY growth (%)</b>										
Sales	17.9	68.1	80.2	42.3	52.5	46.3	4.1	22.8	33.5	24.9
Gross profit	22.4	55.4	64.8	40.3	46.8	38.6	1.8	25.6	38.2	25.6
Operating profit	12.2	78.4	79.4	-2.2	42.7	-27.0	-29.9	14.8	193.8	29.7
Pre-tax profit	-4.7	37.4	80.5	31.5	38.8	12.3	-3.9	17.2	66.4	27.4
Net profit	2.1	52.4	76.5	6.8	32.8	9.9	-14.5	22.8	78.6	28.6
<b>QoQ growth (%)</b>										
Sales	-30.9	70.1	8.9	11.3		-29.0	21.0	28.4	21.1	
Gross profit	-33.1	67.3	10.6	13.3		-33.9	22.8	36.6	24.7	
Operating profit	-25.4	108.0	10.2	-42.8		-44.3	99.9	80.4	46.3	
Pre-tax profit	-51.1	98.6	36.1	-0.4		-58.3	69.8	66.1	41.3	
Net profit	-55.0	98.3	27.3	-5.9		-53.7	54.4	82.8	36.8	
<b>Sales breakdown</b>										
UPS	49%	49%	49%	48%	49%	44%	44%	44%	41%	43%
Inverter	37%	37%	38%	38%	38%	38%	40%	42%	46%	42%
EV charging pile	1%	1%	1%	2%	1%	3%	3%	3%	3%	3%
Others	14%	13%	12%	12%	12%	15%	13%	11%	10%	12%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Deutsche Bank estimates, company data



# Appendix 1

## Important Disclosures

\*Other information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Kstar	002518.SZ	17.36 (CNY) 28 Sep 17	NA

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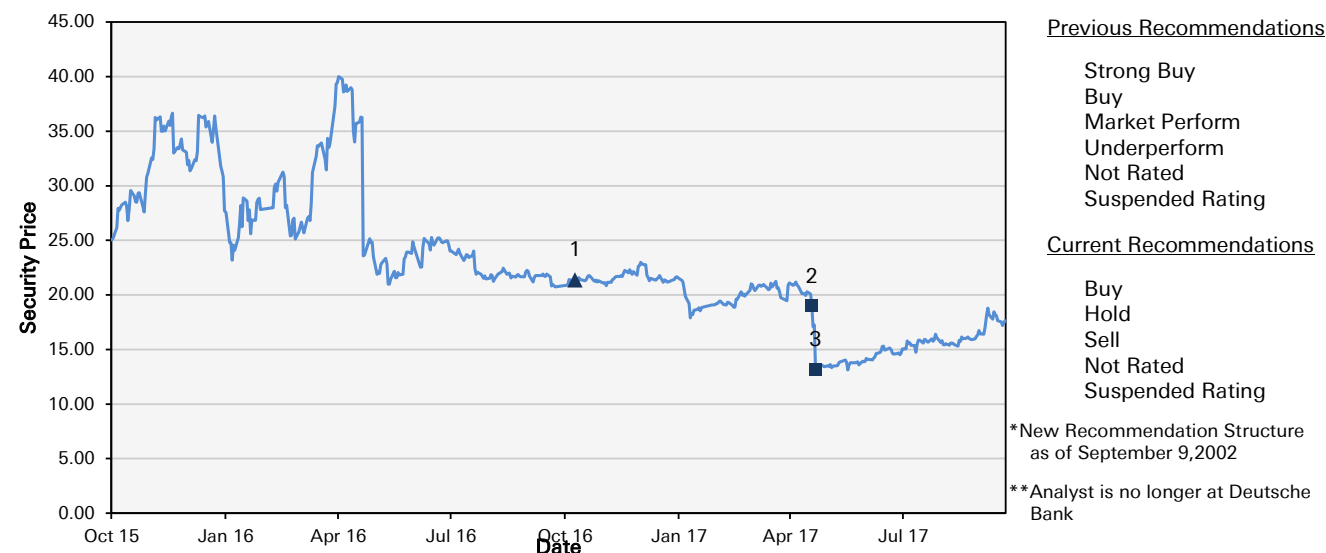
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### Historical recommendations and target price: Kstar (002518.SZ)

(as of 9/28/2017)



1.	16/10/2016:	Upgrade to Buy, Target Price Change CNY27.00	Frank Lin	3.	28/04/2017:	Buy, Target Price Change CNY16.40	Frank Lin
2.	25/04/2017:	Buy, Target Price Change CNY24.00	Frank Lin				



Equity rating key

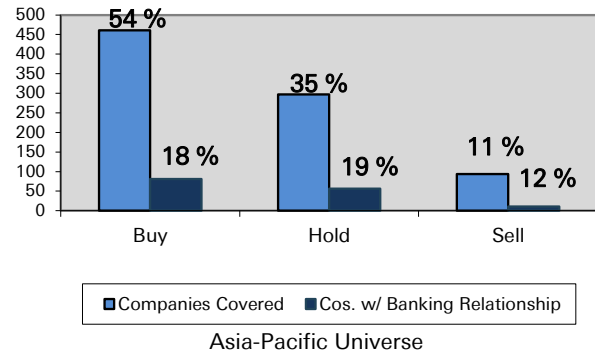
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.

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

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