



Rating
Buy

Asia
China

Industrials
Manufacturing

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

Reuters 300124.SZ Bloomberg 300124 CH Exchange SHZ Ticker 300124

Date
7 November 2017

Forecast Change

Price at 3 Nov 2017 (CNY)	29.81
Price target - 12mth (CNY)	34.30
52-week range (CNY)	30.86 - 19.23
Shenzhen Index	2,067

Thinking bigger, thinking longer

An emerging national champion; raising TP

According to an ancient Chinese proverb, to win a battle, it requires the right time, right place and right people. In the battle for market share in China's industrial automation (IA) sector, we believe all these three factors align with Inovance. In terms of timing, the Chinese government's strong push for manufacturing upgrades and promotion of high-end manufacturing should help to sustain robust IA demand in the next 10 years. On top of it, local players who focus on hardware equipment will accelerate their market share expansion, given the government's intention to promote local champions. Along with management's impressive market insights and distinct "vertical-based" strategy, we believe Inovance is well placed to top the inverter and servo markets in China by 2025. With sustainable long-term growth and an industry-leading position, we believe the stock's current valuation premium is warranted. We raise target price to Rmb34.3.

At the right time

"Made in China 2025" was first unveiled in May 2015, at a time when China's manufacturing industry and IA market were struggling. Thanks to a strong top-down push from the government, China's IA market started to recover in 2H16, with the recovery positively surprising in recent quarters. We view this round of IA recovery as structural instead of cyclical, and hence we believe it is highly likely to persist in the next 10 years. Apart from government support, manufacturers who are facing poor quality, low efficiency, and labor shortages have also started to voluntarily automate their production facilities. This trend has now spread into traditional verticals such as textile machinery, machine tools and metallurgy, signaling that current China's automation upgrades have become broad-based. We expect China's overall IA demand to post a 10% CAGR in 2017-20, while the general servo and low-voltage inverter markets, Inovance's two focused segments, to register a CAGR of c.20% and 10%, respectively, over 2016-20 (vs. +6% and -5% over 2011-16). Over 2021-25, we expect China's general servo and low-voltage inverter markets to witness a CAGR of 10% and 5%, respectively (vs. China's overall IA market: 5%).

In the right place

China's current manufacturing upgrades still largely center on hardware equipment, which has been Inovance's strong suit. In addition, the government's promotion of localization has been intensifying, which would accelerate local players to gain market share. Currently, 65% of China's IA market is still

Valuation & Risks

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Key changes

TP	30.10 to 34.30	↑	14.0%
Sales (FYE)	4,989 to 4,859	↓	-2.6%
Op prof margin (FYE)	24.1 to 23.6	↓	-1.9%
Net profit (FYE)	1,066.8 to 1,032.0	↓	-3.3%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	3.1	21.1	45.4
Shenzhen Index	-0.6	5.7	-4.6

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	20.6
Net debt/equity (%)	-34.0
Book value/share (CNY)	3.18
Price/book (x)	9.4
Net interest cover (x)	-
Operating profit margin (%)	23.6

Source: Deutsche Bank

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dominated by foreign players. In some of Inovance's focused markets, the ratio can be as high as c.90%. Leveraging its deeper understanding of local customers and improving the price-to-performance ratio of its products, Inovance has successfully grown into a local leader capable of challenging MNCs' positions in certain areas. Its low-voltage inverter and general servo already ranked No.3 and No.5, respectively, in China. With accelerating import substitution, we expect Inovance to become the No.2 player in China's low-voltage inverter and No.3 in the general servo market by 2020. By 2025, Inovance is highly likely to lead both markets, based on our estimates.

With the right people

Inovance's success, in our view, is probably more driven by its management than its technology and/or products. A strong evidence to support this is the local competitors of Inovance, in our view. Several started out with similar business at a similar time with similar technology but have fallen significantly behind Inovance after a decade of operations. Driven by management's aggressive but practical manner, Inovance has successfully penetrated into multiple areas including inverter, servo and NEV, and quickly built up a leading position. Inovance recently launched a distinctive "vertical-based" penetration strategy that is completely different from its local and foreign competitors. Instead of pushing existing products to customers, the core strategy is to focus on deeply understanding customers' true needs and developing customized products. Through this practice, Inovance can not only penetrate but also quickly dominate downstream verticals. Air compressor is a good case in point. By coming up with customized drive solutions (inverter+controller), Inovance has rapidly occupied more than 2/3 market share of this particular vertical. The most recent successful cases are textile machinery and metallurgy, and we expect many other verticals to follow.

The same thing can be said about NEV

Inovance has been a proven leader in the NEV bus drive market and we expect such success to be repeated in the logistics and passenger NEV. Growth for logistics NEV drive this year has been ahead of market expectation and we expect such to continue to surprise the market on the upside. By 2020, we expect Inovance to take a 60% share in China's logistics NEV drive market, bringing in Rmb1bn in revenue (or 36% of the total NEV segment) and surpassing NEV bus revenue. Meanwhile, its passenger NEV drive business is also progressing well, having secured 5-6 tier-2 automakers and is likely to secure another 1-2 tier-1 automaker(s) by year-end. Over the longer term, we believe having a strong electronics platform (through its IA business) will give Inovance significant cost advantage over its peers (e.g. lower sourcing pricing for IGBT due to larger volume), which will further facilitate its market share expansion.

Fine-tuning earnings and raising target price; maintaining Buy

We trim our earnings estimates by 3-4% for 2017-19E, mainly reflecting our more conservative assumptions on margins due to the company's heavy R&D investment in the passenger NEV drive business. Still, our 2018-19E earnings are 5-10% higher than consensus forecasts. We see upside potential in our current estimates as we have not factored in meaningful robots sales in coming years. As we turn more bullish on Inovance's long-term growth prospects, we lift our target price by 14% to Rmb34.3, after raising our long-term growth assumptions and rolling forward our valuation timeframe to 2018. We maintain Buy.

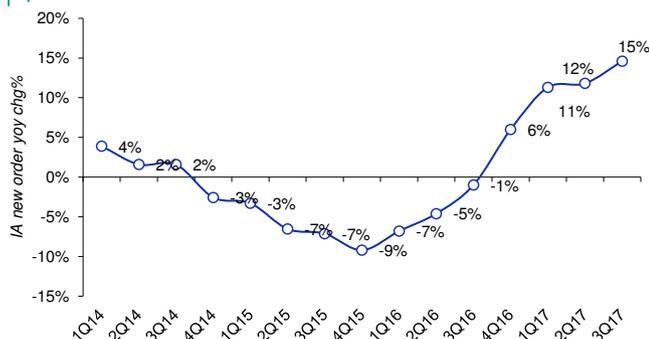


High IA growth to sustain

The right time: China's manufacturing upgrades are accelerating

"Made in China 2025" was first unveiled by the State Council in May 2015, at a time when China's manufacturing industry was clearly struggling and China's IA market was heading south. Approximately one year after the document was released, China's IA market started to recover thanks to the top-down push by the government. The strength of recovery has been ahead of market expectations so far, especially in recent quarters. Despite tougher comps, China's IA new order growth in 3Q17 accelerated to 15% (Figure 1), much stronger than what the market had expected.

Figure 1: Since bottoming out in 4Q15, China's IA market has been recovering strongly, especially in recent quarters



Source: Gongkong, Deutsche Bank

Figure 2: OEM market's (mainly equipment manufacturing industry) outperformance signals China's "real" automation is taking place



Source: Gongkong, Deutsche Bank

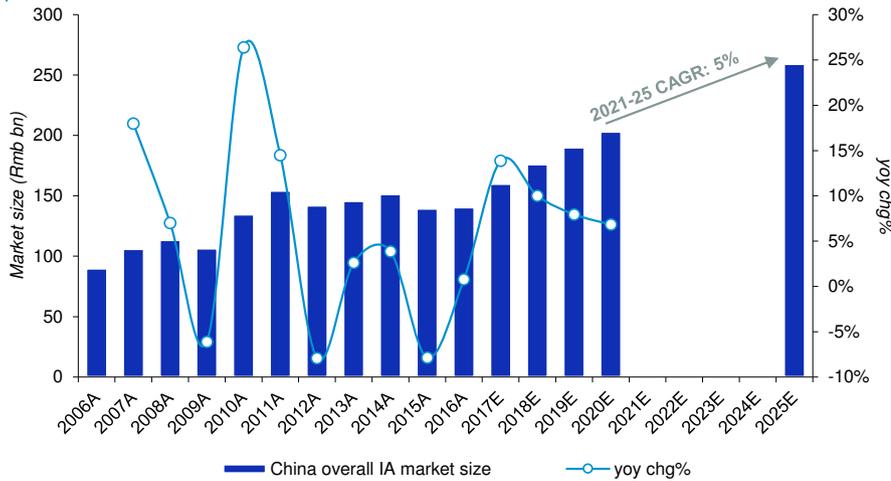
More importantly, growth of the OEM market (mainly equipment manufacturing industry) has already surpassed that of the project market (or end-user verticals) since 2013 and the gap further widened starting 2016 (Figure 2). The emergence of the equipment manufacturing industry signals that China's "real" automation upgrade is indeed taking place.

We believe 2013-16 probably marks the start of China's broad-based automation upgrades and this round of upgrade cycle may last as long as 10-20 years due to the more complicated structure of China's manufacturing industry, which is different from other countries (e.g. Japan's manufacturing industry is mainly driven by 3C and automotive, etc.).

We expect China's overall IA demand to post a 10% CAGR over 2017-20E and a CAGR of 5% over 2021-25E. We forecast the total IA market size in China to reach c.Rmb260bn by 2025.



Figure 3: We expect China's overall IA market to post a 10% CAGR over 2017-20E and 5% CAGR over 2021-25E



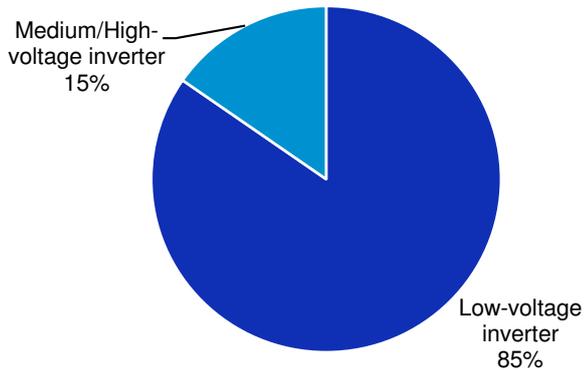
Source: Gongkong, Deutsche Bank estimates.

Low-voltage inverter: 7% CAGR over 2017-25E; a Rmb31bn market by 2025E

By varying the frequency and voltage supplied to the electric motor, inverters can smoothly change the speed and torque of an electric motor. As electrical machinery such as electric motors within plant facilities has become a huge consumers of energy, inverter is critical to energy savings and efficiency improvement. In China, inverter is the largest industrial drive segment, with an annual market size of Rmb19bn in 2016.

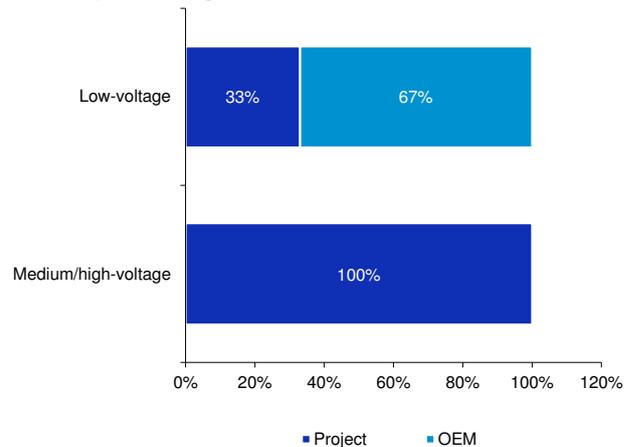
Within China's inverter market, low-voltage inverter accounts for 85% of the total and has been Inovance's primary focus (Figure 4). For low-voltage inverter market, OEM market accounts for over 2/3 while project market represents the remaining 1/3. In contrast, medium/high-voltage inverter is purely driven by project market (Figure 5).

Figure 4: Low-voltage market accounted for 85% of China's inverter market in 2016



Source: Gongkong, Deutsche Bank

Figure 5: China's low-voltage inverter market is mainly driven by OEM segment

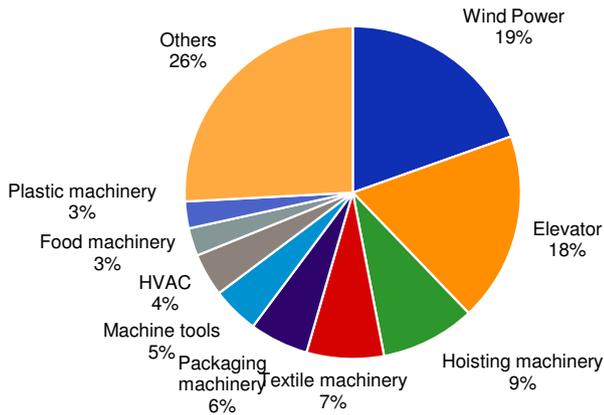


Source: Gongkong, Deutsche Bank



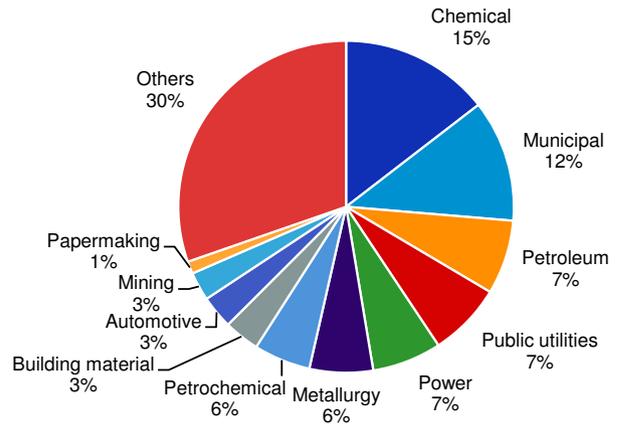
Within the OEM market, wind power, elevator and hoisting machinery are the three largest downstream verticals, which combined account for c.50% of the total (Figure 6). The market size for rest verticals are generally below Rmb1bn, with most around Rmb400-500m (Figure 8).

Figure 6: China's low-voltage inverter OEM market - breakdown by verticals (2016)



Source: Gongkong, Deutsche Bank

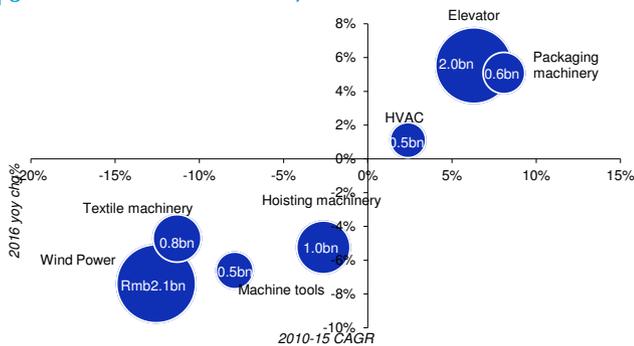
Figure 7: China's low-voltage inverter project market - breakdown by verticals (2016)



Source: Gongkong, Deutsche Bank

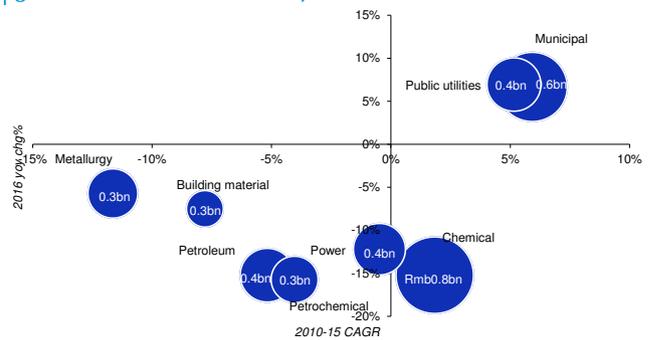
In terms of project market, traditional heavy industries such as chemical, petroleum, power, metallurgy, petrochemical, and building materials, among others, combined account for nearly half of the total demand (Figure 7). In recent years, municipals and public facilities are growing rapidly (Figure 9). These two verticals together now account for c.20% of the total demand of project market.

Figure 8: China's low-voltage inverter OEM market - growth and market size by verticals



Source: Gongkong, Deutsche Bank. Note: Bubble size represents the market size 2016.

Figure 9: China's low-voltage inverter project market - growth and market size by verticals

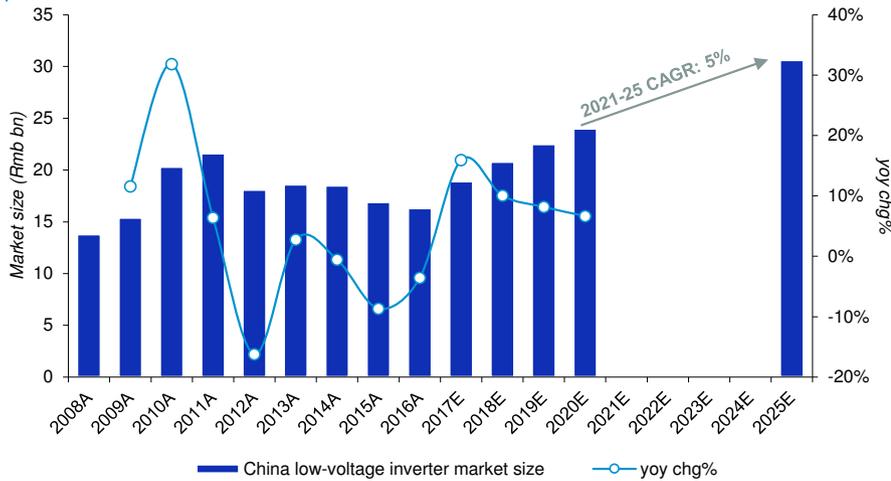


Source: Gongkong, Deutsche Bank. Note: Bubble size represents the market size 2016.

Looking ahead, after three consecutive years of decline since 2014, we expect China's low-voltage inverter market to recover and post a 10% CAGR over 2017-2E, reaching Rmb24bn by 2020E (Figure 10). From 2021-2025E, despite higher base, we expect this market to continue to witness a 5% CAGR, reaching Rmb31bn by 2025E.



Figure 10: We expect China's low-voltage inverter market to post a 10% CAGR over 2017-20E and a 5% CAGR over 2021-25E



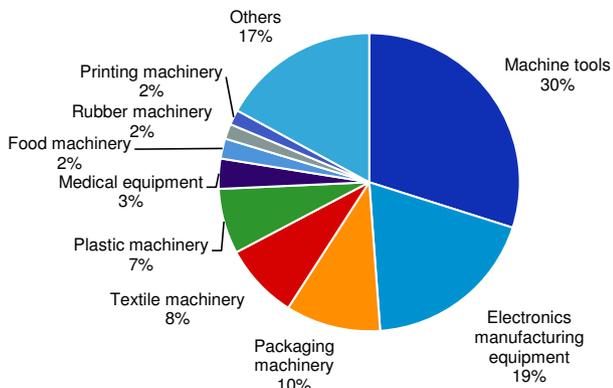
Source: Gongkong, Deutsche Bank

General servos: 14% CAGR over 2017-25E; a Rmb24bn market by 2025

Servo, or more precisely, servo system, is a servo driver and a servo motor. It is essentially an extension of inverter as servo drive is not only capable of controlling speed and torque of a motor (as inverters do) but is also capable of providing position control to a motor. Therefore, servo system has an extensive application in the manufacturing sector and remains a key part of the industrial automation.

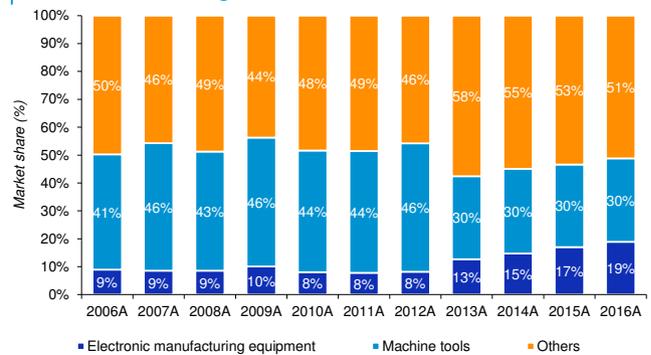
Currently, servo is still at its early stage of penetration in China, evidenced by its much smaller market size (Rmb7.4bn) compared to inverters (Rmb19.3bn). By downstream vertical, machine tool has been the largest one, accounting for 30% of the total market (used to be 45% prior to 2013). On the other hand, electronics manufacturing equipment (mainly 3C) has been the fastest-growing vertical in recent years, accounting for c.20% of the total market in 2016 vs. <10% in 2006 (Figure 12). The two verticals combined accounted for c.50% of China's general servo market in 2016 (Figure 11).

Figure 11: China general servo market breakdown by downstream verticals (2016)



Source: Gongkong, Deutsche Bank

Figure 12: 3C and machine tools combined account for c.50% of China's general servo market



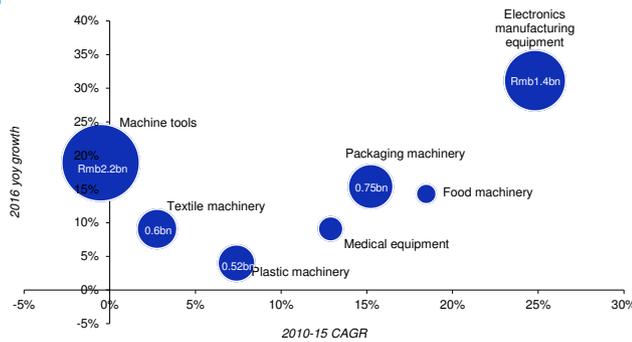
Source: Gongkong, Deutsche Bank



Most other verticals for general servos, however, have a market size of around Rmb100-200mn (Figure 13). These small verticals are widely viewed as mid- to low-end segments, which are the key targets for China's manufacturing upgrades. This points to a substantial growth potential for servo market going forward.

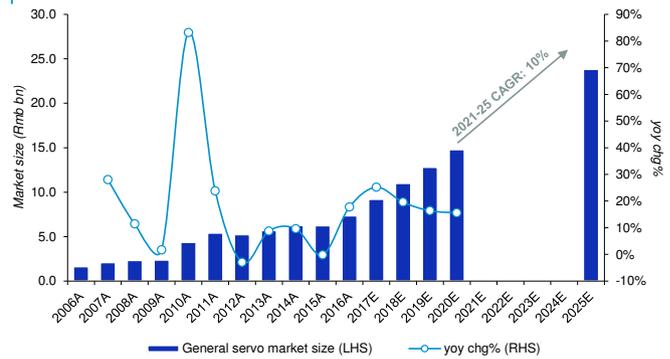
With increasing adoption of servos, we expect China's general servo market to post a CAGR of 19% over 2017-20, reaching Rmb15bn by 2020E (Figure 14). From 2021-25E, we expect the market to continue to witness a 10% CAGR, reaching Rmb24bn by 2025E.

Figure 13: Market size and growth for different verticals of China's general servo market



Source: Gongkong, Deutsche Bank. Note: Bubble size represents the market size in 2016.

Figure 14: We expect China's general servo market to post a CAGR of 19% over 2017-20E and 10% CAGR over 2021-25E

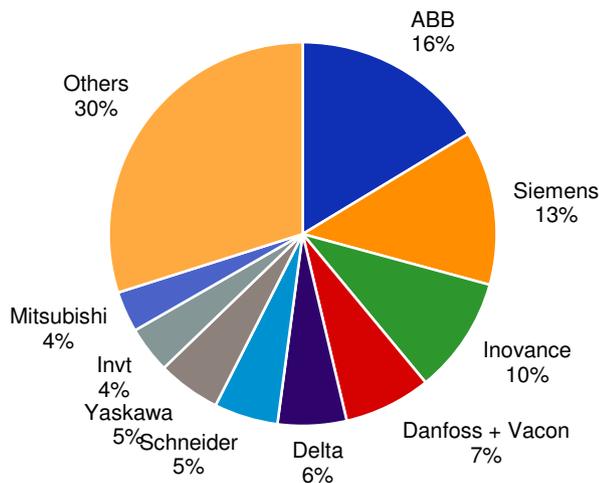


Source: Gongkong, Deutsche Bank estimates.

The right place: import substitution theme to play out

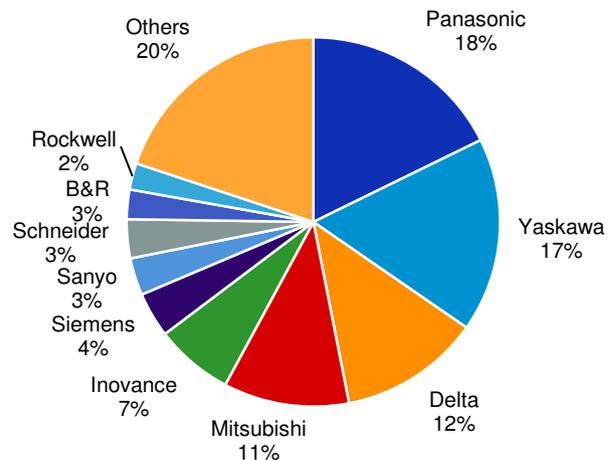
China's current manufacturing upgrades still largely center on hardware equipment, which has been Inovance's strong suit. Over the past 10 years, Inovance has successfully grown into a local leader now capable of challenging MNCs' dominant market positions.

Figure 15: Inovance ranked No.3 in China's low-voltage inverter market in 2016...



Source: Gongkong, Deutsche Bank

Figure 16: ...and No.5 in China's general servo market in 2016



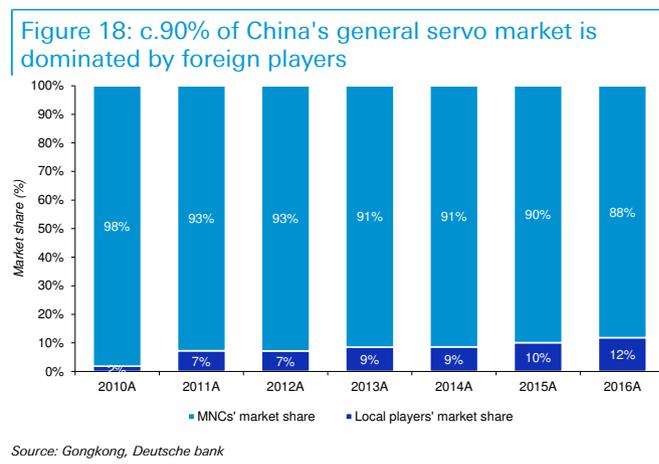
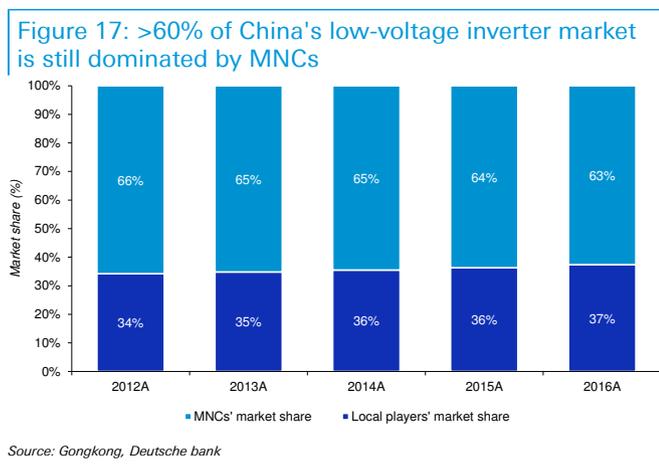
Source: Gongkong, Deutsche bank



Inovance's sales of inverters increased >8x over 2008-16, vs. merely 18% for the overall market. Correspondingly, Inovance's market share rose rapidly from 1% in 2008 to 10% in 2016, making it the No.3 player in China, behind ABB and Siemens (Figure 15).

Similarly, Inovance's servos sales also increased 150% over 2011-16 (vs. +36% for overall market). Its market share increased from 4% in 2011 to 7% in 2016, ranking No.5 in China, following Panasonic, Yaskawa, Delta and Mitsubishi (Figure 16).

While Inovance's progress is certainly encouraging, these two markets that Inovance focused on are still very much dominated by MNCs, which have a combined 88% share of China's general servo market and 63% of China's low-voltage inverter market. For China's overall IA market, 65% of market share is still controlled by MNCs currently.

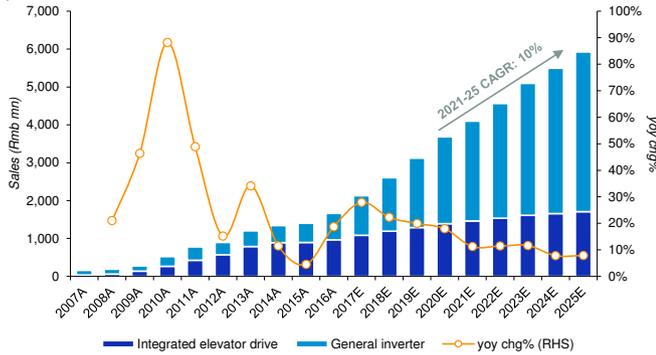


While import substitution has generally turned out to be slow in China's IA market in the last 10 years, we expect it to speed up in the coming decade. Apart from improving product quality and lifting price-to-performance higher than MNC's, the government's intention of raising local content would facilitate market share gains by local players, in our view.

On accelerating import substitution, we expect Inovance to deliver stronger-than-market growth for both inverter and servo segments. We project a revenue CAGR of 20%+ and 40%+ for Inovance's sales of inverters and servos respectively over 2017-20E (vs. 10% and c.20% for the respective markets in China). For 2021-2025E, we project a revenue CAGR of 10% and 16% for Inovance's sales of inverters and servos respectively (vs. 5% and 10% CAGR for the respective markets in China).

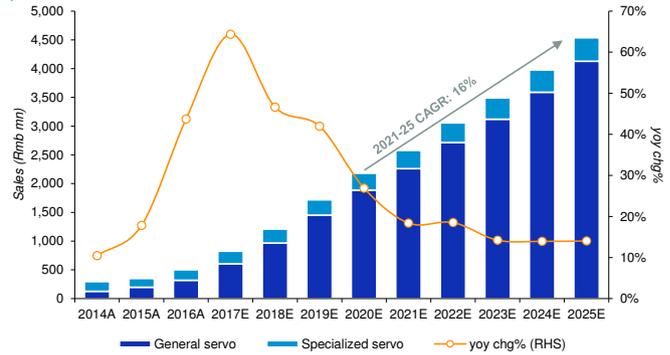


Figure 19: We project revenue CAGR of 22% for Inovance's inverter segment over 2017-20E and 10% CAGR over 2021-25E



Source: Company data, Deutsche Bank estimates

Figure 20: We project revenue CAGR of 44% for Inovance's servo segment over 2017-20E and 16% CAGR over 2021-25E



Source: Company data, Deutsche Bank estimates

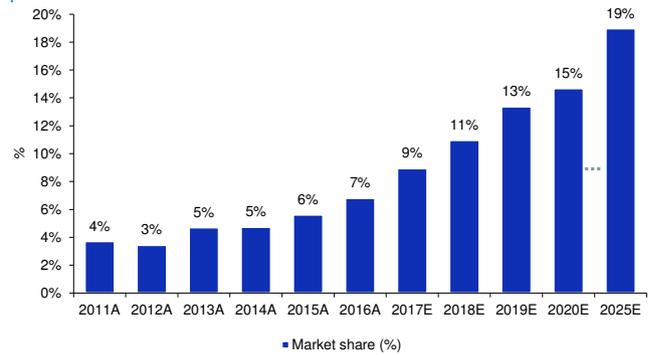
By 2020, we expect Inovance to become the No.2 player (surpassing Siemens) in China's low-voltage inverter market (Figure 21) and the top 3 player in China's general servo market (Figure 22). By 2025, we believe Inovance is highly likely to lead both markets.

Figure 21: We expect Inovance to take 19% share in China's low-voltage inverter market by 2025, leading the market



Source: Company data, Gongkong, Deutsche Bank estimates

Figure 22: We expect Inovance to take 19% share in China's general servo market by 2025, leading the market



Source: Company data, Gongkong, Deutsche Bank estimates

The right people: vertical-based sales strategy highly effective in China

Inovance's success, in our view, is probably more driven by its management than its technology and/or products. A strong evidence to support this is that several Inovance's local competitors, who started similar business at similar time with similar technology, have fallen way behind Inovance after a decade's operations. Driven by management's aggressive but practical manner and strong market insights, Inovance has successfully penetrated into multiple areas including inverter, servo and NEV, and quickly built up a leading position.

Inovance recently launched a distinct "vertical-based" penetration strategy that is completely different from its local and foreign competitors ([Shenzhen Inovance - Key trip takeaways: Inovance's ear is coming](#)). Instead of pushing existing products to customers, the core of the strategy is to focus on deeply understanding customers' true needs and developing customized products. Through this



practice, Inovance can not only penetrate but also quickly dominate downstream verticals.

Air compressor is a good case in point. By coming up with customized drive solution (inverter+controller), Inovance has rapidly occupied more than 2/3 market share of this particular vertical. The most recent successful cases are textile machinery and metallurgy (Figure 23) and we expect many other verticals to follow.

Figure 23: Notable examples of Inovance's vertical-based sales strategy

Industry application	Issues	Solutions	Benefits
Textile machinery	Cooling fans frequently blocked by cotton causing machine overheating	1) Customized cooling system and fan stand; 2) Fanless cooling design	Lower failure rate and higher efficiency; Machines can continuously run for 3+ months without cleaning
Air compressor	High risks of commissioning and failure	Integrated drive solution - inverter + controller (highly customized)	Improved efficiency due to lower failure rate and commissioning time
Metallurgy	High requirement for continuous high-power production hence MNCs used to dominate but maintenance are very costly while equipment upgrades are expensive and have compatibility issue	Customized upgrade solution which does not require 1) the change of cabinet and 2) configuration for hardware and systems	Much less time required for equipment upgrades (1 month vs. 6-12 months); Much less expensive spare parts; On-line maintenance

Source: Deutsche Bank



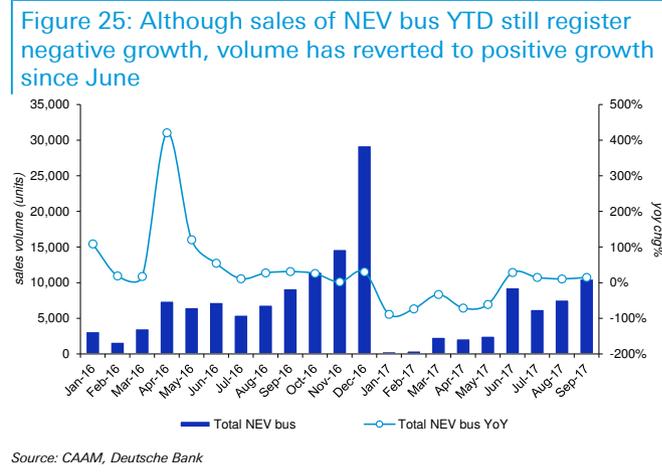
NEV - similar story as IA, we believe

The right time: the global vehicle electrification trend and Chinese government's strong push

We believe the Chinese government is determined to promote NEV, given China's: 1) energy structure; 2) pollution concerns; and 3) ambition for technology leadership. The recent news regarding China developing a plan to phase out vehicles powered by fossil fuels and implementing a dual-credit scheme exemplifies the government's effort to accelerate the development of this market.

The government's crackdown on subsidy cheating in 2016 created disruption to the market but the impact proved to be only short lived. After eight months of suspending catalogue approvals, MIIT resumed approval process in December 2016. Since February, China's NEV market has staged a strong recovery, with volume growth accelerating to 78% in September.

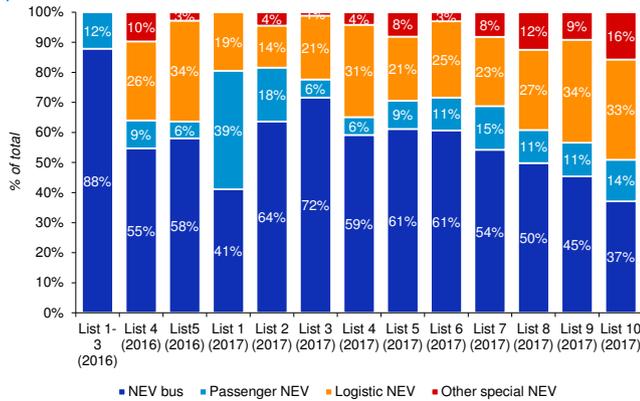
Although YTD sales of NEV bus still register negative growth, volume has reverted to positive growth since June (Figure 25). On the other hand, sales volume of passenger NEV has been strong since February and the strength further accelerated to close to 100% in September (Figure 24).



Moreover, after logistic NEV was included in MIIT's catalogue of vehicles eligible for incentives for the first time in December 2016, we are seeing a steady proportion of the catalogue coming from logistics NEV models (Figure 26), which now accounts for c.25% of the total catalogue approvals so far this year (Figure 27). The recovery of China's NEV market is now across the board.

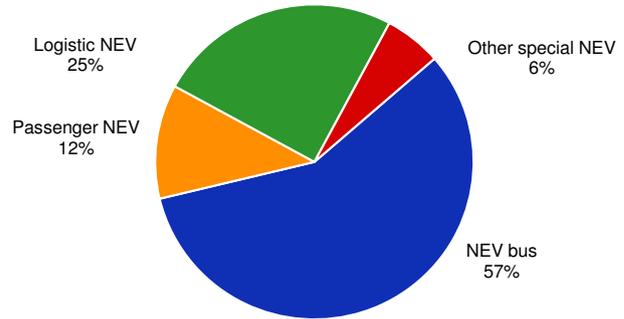


Figure 26: Proportion of logistics NEV has been increasing especially in recent batches of catalogue approvals...



Source: MIIT, Deutsche Bank

Figure 27: ... and accounts for 25% of total models approved in 2017 YTD



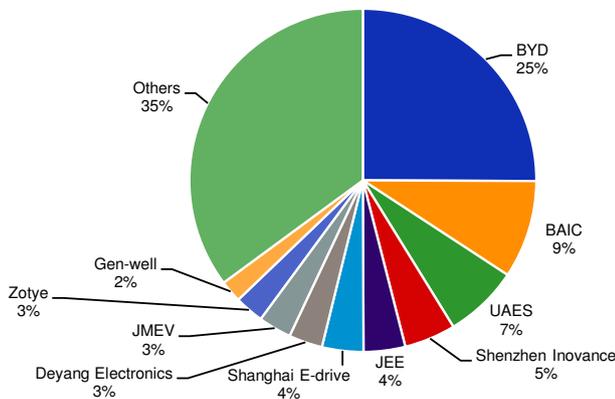
Source: MIIT, Deutsche Bank

The right place: third-party suppliers to prevail over automakers in China's NEV controller market

Electrical controller is indeed an application of Inovance's drive technology in the NEV field. Through the exclusive supply agreement with the local bus leader Yutong, Inovance successfully established its footprint in this market.

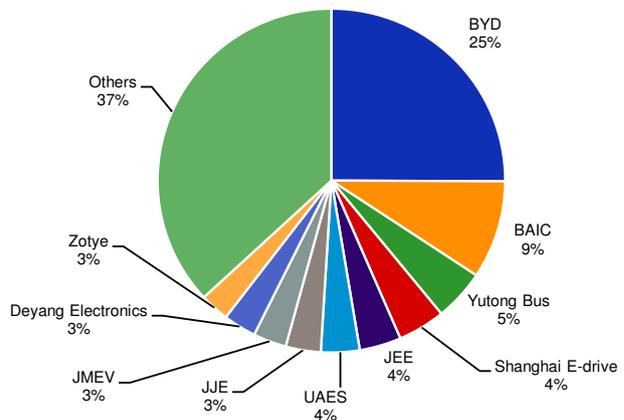
At the current stage, in-house production and sourcing from third-party providers are main options for NEV automakers. The two parties largely equally share the market. BYD, being the major one adopting in-house production, accounts for 25% of total NEV controller market (Figures 28 and 29).

Figure 28: China's NEV controller market share by player (2016)



Source: GGII, Deutsche Bank

Figure 29: China's NEV motor market share by player (2016)



Source: GGII, Deutsche Bank

Based on 2016 data, Yutong's leading position in China's NEV bus market helped lift Inovance ranking to No.4 in China's NEV controller market, coming after BYD, BAIC and UAES. Excluding automakers, Inovance ranked No.2 in 2016, after UAES, a JV between SAIC and Bosch, which mainly focuses on passenger NEV.



Although automakers have strong intention to master the core technology, most local automakers are final assemblers that lack R&D capability to support in-house production. Moreover, when production volume ramps up significantly, substantial quality risk and cost pressure would emerge, which would make in-house production a less optimal option. Third-party suppliers could take advantage of economies of scales by supplying products to the entire industry while most mid to small automakers can not. We therefore believe third-party OEMs will likely gradually gain market share as NEV sales rise.

We believe the competitive landscape for China's third-party NEV drive market is still evolving especially for the passenger NEV segment. Although earlier movers such as UAES and Shanghai E-drive have already established their footprint in this market, we believe Inovance can still penetrate and grab decent market share, leveraging its core competence in drive field, track record in NEV bus area, and cooperation with Brusa.

Cost advantage could be Inovance's key competitiveness over the long run

Moreover, as volume significantly ramps up, we believe Inovance's strong cost competitiveness will enable the company to stand out. Compared to other dedicated third-party NEV driver producers, Inovance has a strong electronics platform (due to its IA business), which would offer substantial cost advantage (e.g. lower sourcing prices for IGBT and capacitors due to larger purchasing volume) since IA and NEV have a large overlap for certain core components. In the long term, as NEV volume significantly ramps up, automakers will likely become increasingly more cost conscious. Therefore, we believe Inovance's strong cost competitiveness will facilitate its market share expansion in future.

The right people: we like management's strategy developed for passenger NEV

Inovance has been a proven NEV drive leader in the NEV bus segment but relatively new to the passenger NEV segment. While being the exclusive NEV controller supplier of Yutong Bus is an endorsement of Inovance's product quality and technology, breaking into passenger OEM's supply chain system is not easy given rigorous requirements for product safety and quality, which requires high R&D investment and close cooperation with auto OEMs.

Fully realizing the challenges, management of Inovance has come up with three strategies:

- **Inosa:** Inovance established Inosa in September 2016 by cooperating with Brusa, which was founded in 1985 and is mainly involved in electric motors and components for NEV (including controller, DC/DC converter, charger, etc.). Brusa's product line coupled with its leading technology in NEV field makes it a nice complement for Inovance. While currently Inovance is mainly focusing on NEV controller, in the longer term, Inovance will develop its electric motor as well as gearbox by leveraging Brusa's advantages.
- **Better product integration:** Existing local players have focused on offering controller plus motor solutions but Inovance is taking this one step further by offering 3-in-1 powertrain solutions consisting of controller, motor and gearbox. The benefits to automobile manufacturers are clear – reduced weight and size with no extra cabling between the



motor and inverter enable the simple integration of the drive units within the vehicle architecture. The company will eventually produce all three components internally. In the near term, Inovance will likely provide motor and controller separately for local NEV makers, mastering the powertrain technology will prepare Inovance for the likely intensifying competition when foreign NEV automakers start to aggressively enter the China market possibly in 2019.

- **ISO certification:** While it is not yet strictly required by local NEV OEMs, getting ISO certified (ISO26262 in this case) – one of the highest safety-related certifications globally – is an endorsement of product safety and quality. Inovance is the first local player to successfully roll out automated production lines and obtain the ISO26262 certification for its NEV drive business. Our channel checks also suggest most local passenger NEV drive suppliers have not been certified.

Leveraging Brusa's leading technology and Inovance's sound strategies (i.e. providing integrated powertrain & acquiring ISO certificate), we are increasingly confident that Inovance will repeat its success in the passenger NEV field.

2017-19: logistics NEV to drive growth; beyond 2019: passenger NEV to take off

Although NEV bus fell short of expectations so far this year, due to weak volume from Yutong as well as iASP cut, logistic NEV positively surprised YTD and will likely continue to exceed expectations in the coming years. Management recently also raised its full-year revenue target for its logistics NEV segment to Rmb350m (from Rmb200m guided at the beginning of 2017).

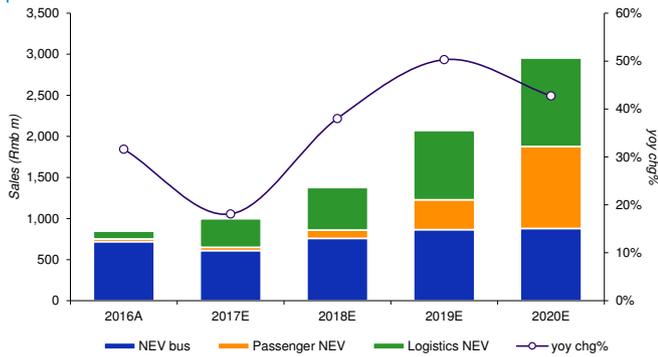
We estimate that the market size of China's logistics NEV drive market will probably be around Rmb800-900m in 2017 (volume of 100k units x ASP of Rmb8-9k), which means that Inovance occupies c.40% market share. We expect the overall market to continue to register a 22% CAGR over 2018-2020 and Inovance to further grow its market share to 60% by 2020E. This suggests that Inovance's logistic NEV revenue will grow at a CAGR of 33% over 2018-20E, more than offset the potential softness from NEV bus. Based on this trend, we expect its logistics NEV to surpass the NEV bus segment and become the largest revenue contributor for the whole NEV segment starting 2019 (Figure 31).

In terms of passenger NEV business, despite surging opex which pressured Inovance's profitability in 2017, the heavy investment in passenger NEV has finally started to show progress. In 1H17, Inovance managed to secure 5-6 tier-2 passenger NEV customers to supply its controller products. Management is confident that it can secure 1-2 tier-1 passenger NEV customer(s) in 2H17 and expects the business to take off in 2019.

We expect Inovance's sales of passenger NEV controller to post a CAGR of 133% over 2017-20. By 2020, we expect Inovance to take a 10% share in China's passenger NEV controller market, with revenue contribution reaching c.Rmb1bn.

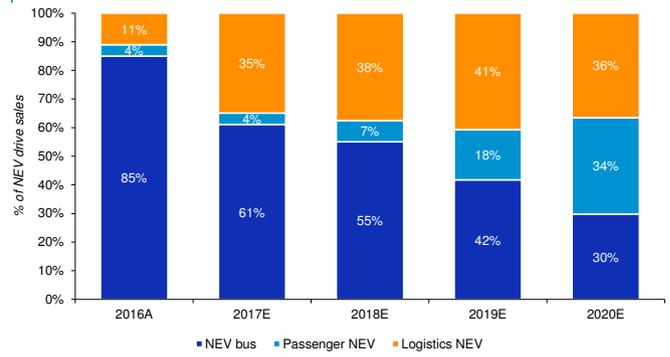


Figure 30: Logistics NEV to drive growth in 2017-19 while passenger NEV to take off in 2020



Source: Company data, Deutsche Bank estimates

Figure 31: By 2020, we expect logistic NEV and passenger NEV to contribute over 1/3 of Invoence's NEV segment sales



Source: Company data, Deutsche Bank estimates



Valuation and risks

Valuation

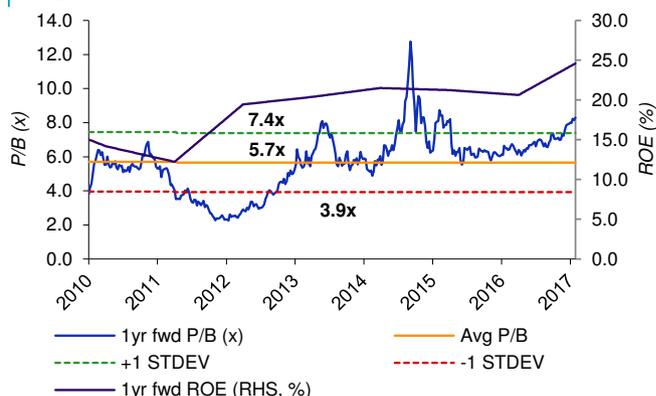
We use a DCF methodology to value Inovance given its stable cash flow. Our revised target price of Rmb34.3 is based on a WACC of 8.0% and a terminal growth assumption of 2%. Our cost of equity assumption incorporates a risk-free rate of 3.9%, an equity risk premium of 5.6% and a beta of 0.95x. Our target price corresponds to a P/E of 39x/30x on 2018/19E, close to one standard deviation above its long-term mid-cycle level, supported by the long-term growth potential of China's intelligent manufacturing sector as well as improving outlook for its passenger NEV drive business.

Figure 32: Shenzhen Inovance – 1-year forward P/E



Source: Company data, Bloomberg Finance LP, Deutsche Bank estimates.

Figure 33: Shenzhen Inovance – 1-year forward P/B vs. ROE



Source: Company data, Bloomberg Finance LP, Deutsche Bank estimates.

Risk

Key downside risks include: 1) an unexpected slowdown in China's economic activity, 2) slower-than-expected new energy vehicle sales in China, 3) slower-than-expected development of new products and market penetration, and 4) poor execution of M&A.



Model updated: 06 November 2017

Running the numbers

Asia

China

Manufacturing

Shenzhen Inovance Technolog

Reuters: 300124.SZ Bloomberg: 300124 CH

Buy

Price (3 Nov 17) CNY 29.81

Target Price CNY 34.30

52 Week range CNY 19.23 - 30.86

Market cap (m) CNYm 49,637
USDm 7,493.5

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.

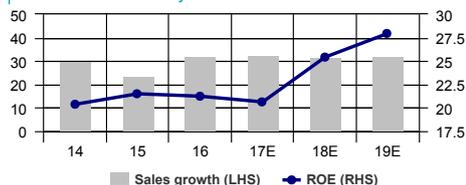
Price Performance



Margin Trends



Growth & Profitability



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Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.43	0.51	0.58	0.62	0.88	1.15
Reported EPS (CNY)	0.43	0.51	0.58	0.62	0.88	1.15
DPS (CNY)	0.50	0.50	0.28	0.30	0.43	0.56
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	49,637	49,637	49,637
Enterprise value (CNYm)	21,271	33,051	28,382	47,822	47,160	46,198

Valuation Metrics

P/E (DB) (x)	34.4	42.3	32.7	48.1	33.8	25.9
P/E (Reported) (x)	34.4	42.3	32.7	48.1	33.8	25.9
P/BV (x)	3.21	4.56	6.94	9.38	7.94	6.67
FCF Yield (%)	1.7	1.7	0.9	1.5	2.4	3.4
Dividend Yield (%)	3.4	2.3	1.5	1.0	1.5	1.9
EV/Sales (x)	9.5	11.9	7.8	9.8	7.4	5.5
EV/EBITDA (x)	28.4	36.2	24.9	37.9	26.4	19.8
EV/EBIT (x)	30.1	38.4	27.1	41.6	28.5	21.2

Income Statement (CNYm)

Sales revenue	2,243	2,771	3,660	4,859	6,393	8,452
Gross profit	1,127	1,343	1,761	2,204	2,913	3,793
EBITDA	749	912	1,141	1,263	1,786	2,331
Depreciation	26	32	59	69	81	93
Amortisation	16	19	32	45	52	61
EBIT	707	862	1,049	1,149	1,653	2,177
Net interest income/(expense)	69	45	11	33	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	1,181	1,698	2,240
Income tax expense	85	71	63	106	170	246
Minorities	24	25	48	43	61	80
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	666	809	932	1,032	1,467	1,914
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	666	809	932	1,032	1,467	1,914

Cash Flow (CNYm)

Cash flow from operations	524	802	420	1,002	1,443	1,965
Net Capex	-127	-207	-136	-250	-258	-265
Free cash flow	397	594	284	752	1,185	1,700
Equity raised/(bought back)	77	190	584	0	0	0
Dividends paid	-401	-411	-415	-458	-507	-721
Net inc/(dec) in borrowings	0	-5	91	-117	0	-2
Other investing/financing cash flows	63	-495	173	33	45	63
Net cash flow	137	-127	717	210	723	1,040
Change in working capital	-148	-30	-631	-155	-173	-120

Balance Sheet (CNYm)

Cash and other liquid assets	1,836	1,408	1,708	1,917	2,641	3,680
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	5,819	7,014	8,562
Total assets	4,671	5,947	7,974	9,340	11,384	14,083
Interest bearing debt	0	15	128	11	11	9
Other liabilities	1,025	1,642	2,863	3,730	4,753	6,182
Total liabilities	1,025	1,657	2,992	3,741	4,764	6,190
Shareholders' equity	3,468	4,060	4,716	5,290	6,250	7,443
Minorities	178	230	267	310	371	450
Total shareholders' equity	3,646	4,290	4,982	5,599	6,620	7,893
Net debt	-1,836	-1,393	-1,580	-1,906	-2,630	-3,672

Key Company Metrics

Sales growth (%)	29.9	23.5	32.1	32.8	31.6	32.2
DB EPS growth (%)	18.2	20.1	13.1	6.9	42.1	30.5
EBITDA Margin (%)	33.4	32.9	31.2	26.0	27.9	27.6
EBIT Margin (%)	31.5	31.1	28.7	23.6	25.9	25.8
Payout ratio (%)	117.0	97.5	48.2	49.1	49.1	49.1
ROE (%)	20.4	21.5	21.2	20.6	25.4	28.0
Capex/sales (%)	5.7	7.5	3.7	5.1	4.0	3.1
Capex/depreciation (x)	3.0	4.1	1.5	2.2	1.9	1.7
Net debt/equity (%)	-50.3	-32.5	-31.7	-34.0	-39.7	-46.5
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	29.81 (CNY) 3 Nov 2017	NA

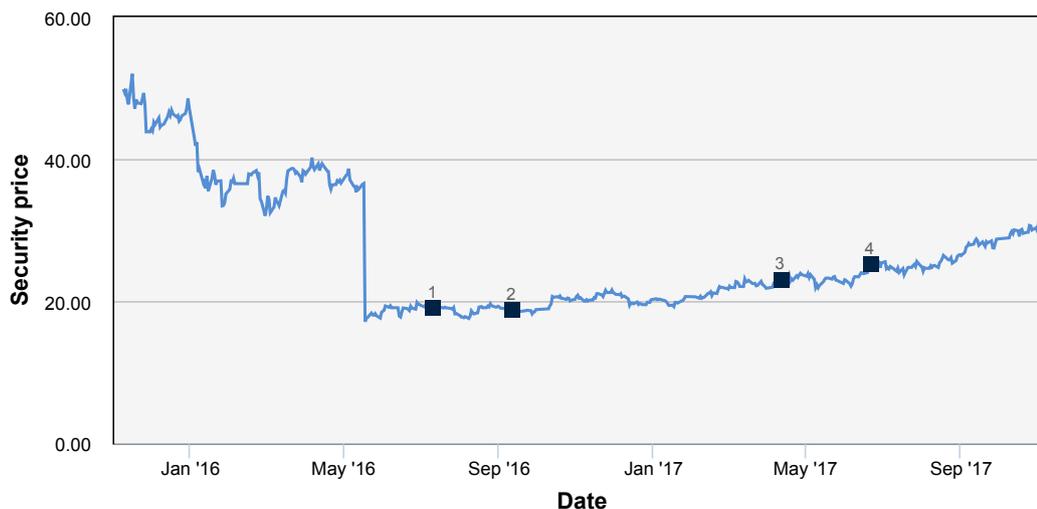
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Historical recommendations and target price. Shenzhen Inovance Technology Co., Ltd. (300124.SZ)

(as of 11/03/2017)



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

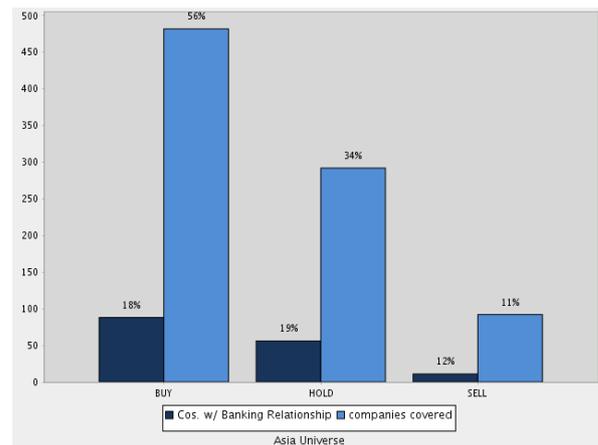
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

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

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

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