



Neutral

# Shanghai STEP Electric Corp. (002527.SZ)

Lack of growth momentum priced in; up to Neutral, with limited downside

**002527.SZ** 12m Price Target: **Rmb8.00** Price: **Rmb8.72** Downside: **8.3%**

We upgrade STEP to Neutral from Sell as it has almost reached our target price of Rmb8.0 (8% downside). We believe the market has fully priced in the company's elevator market share loss coupled with the margin deterioration concerns. Since STEP was added to the Sell List on September 9, 2016, the stock price is down 42% vs. China A-share automation coverage average up 39% and CSI 300 up 16%.

STEP has been losing elevator control market share to its local competitor Inovance since 2H15, and we expect the share loss situation to stabilize at 4% into 2020E vs. Inovance at 11%. Going forward, we think it is unlikely the segment's margin will see further substantial price cut but rather a modest 0.5pp p.a. margin decline. On the other hand, we believe the company's robotics segment lacks drivers (e.g. active new products rollout/economy of scale) to outperform.

## Valuation

Our 12-month target price of Rmb8.0 is unchanged (based on 2018E EV/GCI vs. CROCI/WACC, with the sector cash return multiple unchanged at 3.10X, with a 20% discount). The company dropped into the bottom quartile of our global automation CROCI league in 2017 (9.8%), and we see no signs of a turnaround into 2020E (8.6%). STEP is currently trading at 26X/25X 2018E/2019E P/E against 7% EPS 2018-2020E CAGR, vs. 36X/25X and 30% for our China onshore automation coverage.

## Key risks

Upside: better than expected robotics sales; regaining momentum to gain elevator control market share; downside: margins decline due to competition and higher than expected interest expense.

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## Key Data

Market cap: Rmb5.4bn / \$855.1mn  
Enterprise value: Rmb6.0bn / \$953.5mn  
3m ADTV: Rmb24.5mn / \$3.8mn  
China  
A-share Industrials  
M&A Rank: 3

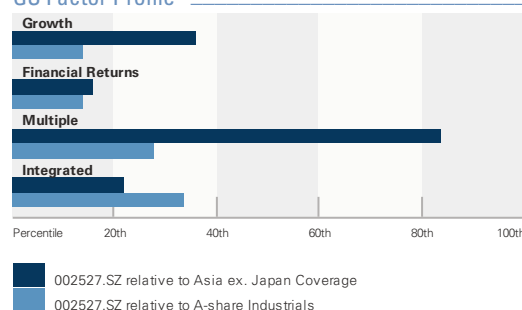
## GS Forecast

	12/16	12/17E	12/18E	12/19E
Revenue (Rmb mn)	2,726.6	3,413.5	3,929.3	4,258.5
EBITDA (Rmb mn)	243.9	199.4	260.5	278.9
EPS (Rmb)	0.28	0.23	0.33	0.35
P/E (X)	54.8	37.4	26.3	24.6
P/B (X)	3.5	1.9	1.8	1.7
Dividend yield (%)	0.7	0.5	0.8	0.8
Net debt/EBITDA (X)	1.2	3.2	2.9	2.8
CROCI (%)	10.4	8.4	8.8	8.7
FCF yield (%)	2.3	(2.0)	(1.6)	(0.1)

	3/17	6/17	9/17E	12/17E
EPS (Rmb)	0.03	0.13	0.09	(0.01)

## GS Factor Profile



Source: Company data, Goldman Sachs Research estimates.  
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Rating since Mar 25, 2018

## Ratios &amp; Valuation

	12/16	12/17E	12/18E	12/19E
P/E (X)	54.8	37.4	26.3	24.6
P/B (X)	3.5	1.9	1.8	1.7
FCF yield (%)	2.3	(2.0)	(1.6)	(0.1)
EV/EBITDA (X)	23.3	30.3	23.7	22.3
CROCI (%)	10.4	8.4	8.8	8.7
ROE (%)	7.0	5.2	7.0	7.1
Net debt/equity (%)	10.3	22.1	24.8	24.9
Interest cover (X)	5.1	1.7	1.7	1.8
Days inventory outst, sales	91.5	85.6	90.3	92.6
Receivable days	136.5	146.8	163.3	172.8
Days payable outstanding	124.9	121.5	140.3	144.4
DuPont ROE (%)	6.3	5.1	6.8	6.9
Turnover (X)	0.6	0.5	0.6	0.6
Leverage (X)	1.6	2.2	2.2	2.2

## Growth &amp; Margins (%)

	12/16	12/17E	12/18E	12/19E
Total revenue growth	80.9	25.2	15.1	8.4
EBITDA growth	23.5	(18.3)	30.6	7.1
EPS growth	(14.2)	(15.6)	42.1	7.1
DPS growth	(9.1)	(53.4)	42.1	7.1
EBIT margin	6.6	3.0	4.0	3.9
EBITDA margin	8.9	5.8	6.6	6.5
Net income margin	6.3	4.2	5.2	5.2

## Price Performance



Source: FactSet. Price as of 23 Mar 2018 close.

## Income Statement (Rmb mn)

	12/16	12/17E	12/18E	12/19E
Total revenue	2,726.6	3,413.5	3,929.3	4,258.5
Cost of goods sold	(2,032.6)	(2,640.9)	(3,032.0)	(3,278.5)
SG&A	(321.9)	(387.3)	(435.5)	(480.6)
R&D	(147.0)	(221.9)	(235.8)	(255.5)
Other operating inc./exp.)	(45.2)	(61.4)	(70.7)	(76.7)
<b>EBITDA</b>	<b>243.9</b>	<b>199.4</b>	<b>260.5</b>	<b>278.9</b>
Depreciation & amortization	(64.1)	(97.4)	(105.2)	(111.7)
<b>EBIT</b>	<b>179.9</b>	<b>102.0</b>	<b>155.3</b>	<b>167.2</b>
Net interest inc./exp.)	(27.5)	(50.1)	(66.2)	(68.0)
Income/(loss) from associates	7.3	10.0	10.0	10.0
<b>Pre-tax profit</b>	<b>222.5</b>	<b>205.9</b>	<b>241.5</b>	<b>258.6</b>
Provision for taxes	(52.9)	(51.5)	(36.2)	(38.8)
Minority interest	1.5	(10.0)	0.0	—
Preferred dividends	—	—	—	—
<b>Net inc. (pre-exceptionals)</b>	<b>171.1</b>	<b>144.4</b>	<b>205.3</b>	<b>219.8</b>
Post-tax exceptionals	—	—	—	—
<b>Net inc. (post-exceptionals)</b>	<b>171.1</b>	<b>144.4</b>	<b>205.3</b>	<b>219.8</b>
<b>EPS (basic, pre-exception) (Rmb)</b>	<b>0.28</b>	<b>0.23</b>	<b>0.33</b>	<b>0.35</b>
<b>EPS (diluted, pre-exception) (Rmb)</b>	<b>0.28</b>	<b>0.23</b>	<b>0.33</b>	<b>0.35</b>
<b>EPS (basic, post-exception) (Rmb)</b>	<b>0.28</b>	<b>0.23</b>	<b>0.33</b>	<b>0.35</b>
<b>EPS (diluted, post-exception) (Rmb)</b>	<b>0.28</b>	<b>0.23</b>	<b>0.33</b>	<b>0.35</b>
DPS (Rmb)	0.10	0.05	0.07	0.07
Div. payout ratio (%)	36.2	20.0	20.0	20.0

## Balance Sheet (Rmb mn)

	12/16	12/17E	12/18E	12/19E
Cash & cash equivalents	598.8	1,642.0	1,525.5	1,477.5
Accounts receivable	1,136.4	1,609.7	1,906.8	2,124.8
Inventory	696.3	904.7	1,038.7	1,123.2
Other current assets	34.6	34.6	34.6	34.6
<b>Total current assets</b>	<b>2,466.1</b>	<b>4,191.0</b>	<b>4,505.5</b>	<b>4,760.1</b>
Net PP&E	422.5	435.1	473.0	524.1
Net intangibles	1,408.7	1,536.4	1,481.0	1,425.7
Total investments	125.0	135.0	145.0	155.0
Other long-term assets	15.8	60.5	90.7	110.4
<b>Total assets</b>	<b>4,438.1</b>	<b>6,358.0</b>	<b>6,695.2</b>	<b>6,975.2</b>
Accounts payable	672.9	1,085.3	1,246.0	1,347.3
Short-term debt	880.0	1,091.0	1,091.0	1,091.0
Other current liabilities	128.7	95.5	107.7	110.6
<b>Total current liabilities</b>	<b>1,681.6</b>	<b>2,271.8</b>	<b>2,444.7</b>	<b>2,548.9</b>
Long-term debt	0.0	1,181.0	1,181.0	1,181.0
Other long-term liabilities	36.8	60.0	60.0	60.0
<b>Total long-term liabilities</b>	<b>36.8</b>	<b>1,241.0</b>	<b>1,241.0</b>	<b>1,241.0</b>
<b>Total liabilities</b>	<b>1,718.4</b>	<b>3,512.8</b>	<b>3,685.7</b>	<b>3,789.9</b>
Preferred shares	—	—	—	—
Total common equity	2,718.9	2,834.5	2,998.7	3,174.6
<b>Minority interest</b>	<b>0.7</b>	<b>10.7</b>	<b>10.7</b>	<b>10.7</b>
<b>Total liabilities &amp; equity</b>	<b>4,438.1</b>	<b>6,358.0</b>	<b>6,695.2</b>	<b>6,975.2</b>
Gross cash invested (ex cash)	3,317.8	3,867.9	4,223.8	4,539.6
Net debt, adjusted	281.2	630.0	746.5	794.5
Average capital employed	2,475.3	3,238.0	3,615.6	3,867.9
BVPS (Rmb)	4.38	4.57	4.84	5.12

## Cash Flow (Rmb mn)

	12/16	12/17E	12/18E	12/19E
Net income	171.1	144.4	205.3	219.8
D&A add-back	64.1	97.4	105.2	111.7
Minority interest add-back	(1.5)	10.0	0.0	—
Net (inc)/dec working capital	(45.7)	(269.3)	(270.3)	(201.2)
Other operating cash flow	49.3	13.2	(10.0)	(10.0)
<b>Cash flow from operations</b>	<b>237.2</b>	<b>(4.4)</b>	<b>30.2</b>	<b>120.3</b>
Capital expenditures	(25.7)	(102.4)	(117.9)	(127.2)
Acquisitions	(4.0)	(180.0)	—	—
Divestitures	2.2	—	—	—
Others	(530.3)	—	—	—
<b>Cash flow from investing</b>	<b>(557.8)</b>	<b>(282.4)</b>	<b>(117.9)</b>	<b>(127.2)</b>
Dividends paid (common & pref)	(16.4)	(62.0)	(28.9)	(41.1)
Inc/(dec) in debt	0.0	1,392.0	0.0	0.0
Other financing cash flows	282.3	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>265.9</b>	<b>1,330.0</b>	<b>(28.9)</b>	<b>(41.1)</b>
<b>Total cash flow</b>	<b>(51.1)</b>	<b>1,043.2</b>	<b>(116.5)</b>	<b>(48.0)</b>
Free cash flow	211.5	(106.8)	(87.6)	(6.9)

Source: Company data, Goldman Sachs Research estimates.

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**Growth** is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

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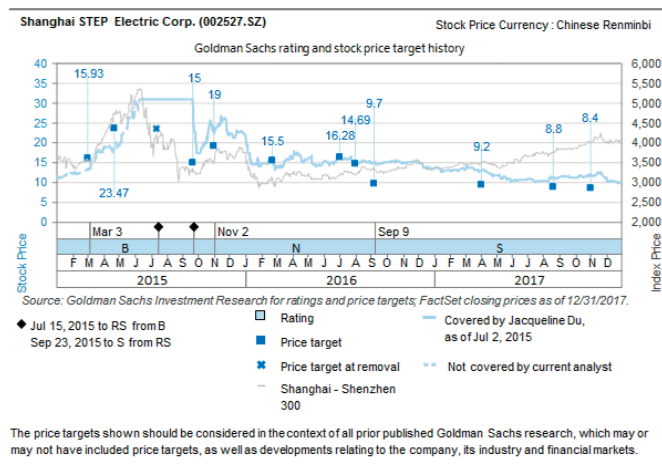
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