



Rating
Buy

Asia
China

Industrials
Manufacturing

Company
NARI Tech Alert

Reuters 600406.SS Bloomberg 600406.CH Exchange SHH Ticker 600406

Date
27 August 2018

Results

Price at 27 Aug 2018 (CNY)	15.04
Price target - 12mth (CNY)	19.80
52-week range (CNY)	21.16 - 14.71
Shanghai Composite	2,729

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Stock data	
Market cap (CNYm)	36,531
Market cap (USDm)	5,307
Shares outstanding (m)	4,392.8
Major shareholders	–
Free float (%)	54
Avg daily value traded (USDm)	18.2
Source: Deutsche Bank	

Key data			
FYE 12/31	2017A	2018E	2019E
Sales (CNYm)	24,198	27,282	31,071
Net Profit (CNYm)	3,240.5	3,686.9	4,258.6
DB EPS (CNY)	0.79	0.84	0.93
PER (x)	22.1	17.9	16.2
Yield (net) (%)	2.1	2.5	3.1
Source: Deutsche Bank			

1H18 results highlight			
	1H17	1H18	YoY
Sales revenue	8,791	10,568	20%
Grid and industrial automation	4,882	6,663	36%
Power generation, hydro and environmental protection	1,032	795	-23%
Relay protection & flexible transmission	1,780	1,386	-22%
Power information communication	954	1,427	50%
EPC & others	144	297	107%
Gross profit	2,530	2,906	15%
Grid and industrial automation	1,468	1,893	29%
Power generation, hydro and environmental protection	95	119	26%
Relay protection & flexible transmission	703	501	-29%
Power information communication	202	290	43%
EPC & others	63	103	65%
Gross margin	28.8%	27.5%	-1.3ppt
Grid and industrial automation	30.1%	28.5%	-1.6ppt
Power generation, hydro and environmental protection	9.2%	15.0%	5.8ppt
Relay protection & flexible transmission	39.5%	36.1%	-3.3ppt
Power information communication	21.2%	20.3%	-0.9ppt
EPC & others	43.5%	34.7%	-8.8ppt
Net profit attr. To equity shareholders	897	1,352	51%
Core net profit attr. To equity shareholders (DBs)	872	1,084	24%
Source: Deutsche Bank			

Impressive results, solid outlook

NARI reported strong 1H results, with headline net profit +51%. Taking out the benefit from lower AR provision and FX gain, core profit rose 24% yoy, ahead of our [expectation](#) (+18%). We appreciate such growth and defensiveness achieved against this tough sector environment (grid investment down 16% in 1-7M18). Supported by resilient earnings performance, NARI outperformed SHCOMP by 5% YTD, vs. peers that generally underperformed by >10%. We keep Buy on steady growth outlook, likely improved trend in grid investment and potential catalyst from SOE reform progress, meanwhile low market expectation as reflected in valuation (15x 2019PE).

1H results highlights

Revenue was +20% yoy, driven by strong growth in power grid automation (specifically distribution automation and grid safety products) and power information communication, even relay protection & flexible transmission segment dropped 22% due to less UHV projects. **GPM** slightly contracted by 1.3ppt to 27.5%, more of a result of product mix change, i.e. 1) less high-margin UHV revenue, 2) more lower-margin distribution automation revenue. GPM was partially lifted by contraction of solar EPC business, where we find this segment has narrowed loss by Rmb17m yoy to Rmb35m loss in 1H. **Opex ratio** (sales/admin exp. of revenue) was reduced by 1.2ppt yoy to 14.5%, showing benefit of synergy after asset consolidation and operating leverage.

Order inflow supports earnings outlook

We feel incrementally confident NARI will achieve its full-year sales/core profit growth guidance of +10%/+15%, considering strong 1H results and order momentum. 1H order inflow grew 15% yoy, driven by Zhangbei project, grid automation and power communication products. In particular, this means Flexible transmission segment would turn from a dragger into a driver next year. Mgmt still targets new order growth of +10% this year, but does not exclude a possibly better result given 1) sequentially improved grid investment trend and 2) more proactive bidding in leasing model-based projects.

SOE reform progress accelerates

NARI set up a separate department dedicated to SOE reform in Aug-17, when its parentco asset injection was done. Into 2H18, SOE reform progress seems to accelerate, pushed from top-down level. NARI Group is recently included in the "SOE Reform Double 100 Action List". It is required to submit comprehensive reform plan by this Sept, which should focus on ownership mix reform. This could potentially come in the form of stock incentive scheme for key mgmt/sales/R&D staff, along with profit guarantee as assessment basis. If it is realized, this will help better align interest between shareholders and employees and further enhance earnings visibility.

Deutsche Bank AG/Hong Kong

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