

Equities

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Engineering Sector in China

Field Trip Highlights Increased Uncertainty

- **Field Trip Suggests Demand Environment Is Uncertain** – The key message was one of increased uncertainty from a week spent in China meeting nine Chinese companies, two European companies, construction dealers and a government official. The uncertainty is different compared to our previous trips to China, where the demand outlook was clearer.
- **Mixed Trading Today, “Hope” of 2H Improvement** – Current trading in June is mixed and all companies are “hoping” for recovery in 2H, expecting demand to bottom out in 3Q followed by a gradual recovery in 4Q as a result of the recent policy easing. No sharp recovery or a big stimulus plan (equivalent to 2010) is expected.
- **Government Change Impact May Not be Immediate** – October is the month of the new government transition, but it is likely to take time – one meeting suggested a full government-wide transition may not be completed until the end of 2013. No fundamental changes to policies are expected, rather an execution of strategy set in the 12th FYP. The change towards a consumption-driven model might take time. In the near-term FAI will continue to be the main contributor to growth, however, growing at a much slower pace than in the past.
- **Going Global** – Expansion outside of China is on the strategic agenda of every Chinese company we met with and the target is to expand sales outside of China from today's c5-10% of group sales towards 30-50% (depending on the company). Countries of focus are Brazil, Russia, India, Africa and Middle East. The weaker economic development in Europe and the US means these regions were not generally seen as immediate priorities.
- **M&A is in Focus** – Acquisitions (outside of China) are on the strategic agenda of most of the Chinese companies we met with. At this stage large-scale acquisitions outside of China are unlikely, rather the focus is to be more on bolt-on acquisitions that provide access to technology and distribution channels. Based on our discussions with the companies, possible acquisition targets in our sector are more likely to be mid-cap names, with a possible bias towards German and UK companies.
- **Top Picks** – We reiterate our Neutral stance on the sector (which we downgraded from Overweight in March this year). Our top Buy ideas are ABB, IMI, GEA and Sandvik. Our top Sell ideas are Metso, Philips, SKF and Schneider.
- **Who We Met** – We met with Baosteel, Goldwind, Hollysys, Lonking, Marohn Elevator, Morgan Crucible, Shanghai Electric, Sinovel, SKF and Zoomlion. We also met with a leading construction equipment maker and two of its concrete pump and excavator dealers, as well as a government official related to transport infrastructure investment.

■ Industry Overview

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Appendix A-1

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