



Rating
Buy

Asia
China

Technology
Hardware & Equipment

Company
Dahua

Reuters 002236.SZ Bloomberg 002236 CH Exchange SHZ Ticker 002236

Date
24 July 2017

Forecast Change

Price at 21 Jul 2017 (CNY)	24.03
Price target - 12mth (CNY)	27.30
52-week range (CNY)	24.91 - 13.16
Shenzhen Index	1,930

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Key changes

Price target	19.40 to 27.30	↑	40.7%
Sales (FYE)	17,162 to 18,350	↑	6.9%
Op prof margin (FYE)	-	↑	0.0%
Net profit (FYE)	2,505.6 to 2,644.2	↑	5.5%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	5.1	40.3	63.5
Shenzhen Index	-2.2	-3.9	-9.5

Source: Deutsche Bank

Accelerating growth from AI

Potential winner of a PPP project

Dahua has submitted a bid for a PPP tender by Shache country in Xinjiang for a safe city project, which includes infrastructure as well as a public video sharing platform. The Xinjiang government has announced that Dahua is the top-ranked bidder and is likely to win this 10-year project (1 year of construction and 9 years of operation), for a total amount of CNY4.3bn. Winning this PPP project will be positive to Dahua's growth outlook as we model this project to contribute to 4%/12% of revenue in 2017/2018, respectively. While the bid is not final, we have factored in the potential contribution to our earnings forecast. We maintain Buy.

Video surveillance rides on the AI trend

We have been highlighting that the video surveillance sector will ride on the future AI and deep learning trends with increasing video analytics applications. Surveillance cameras equipped with AI capability would be able to detect potential public safety issues and alert officers more efficiently. Apart from crime monitoring, these AI-based surveillance systems can be used to improve emergency services and disaster response rates; to monitor traffic and to implement smart manufacturing. Following the partnership with nVidia and Intel (Movidius), Dahua has introduced AI video surveillance products for various applications. Although the current contribution is limited, we expect the AI products to further strengthen its suites of solution offerings and become its key growth drivers.

Accelerated profit growth

In addition to Dahua's continual market share gain and rising contribution from its solutions, the AI applications and potential PPP project should further propel Dahua's growth outlook, and we expect revenue growth to accelerate to 38%/36% in 2017/2018 from 32% in 2016. The rise in revenue scale should also enable Dahua to reverse the increasing opex ratio trend in 2013-16. We expect the opex ratio to decline from 27% in 2016 to 26%/25% in 2017/2018, respectively. Our new 2017/2018 EPS are CNY0.9/1.2, respectively.

Valuation and risks

We maintain Buy on Dahua and raise the TP from CNY19.4 to CNY27.3 on our increased 2017/2018 earnings forecasts by 6%/14%. We also lift our target P/E multiple from 20x 2H17-1H18 to 22x 2018E due to its accelerated profit growth and ROE expansion. We now expect profit growth to accelerate to 45%/36% in 2017/2018 due to AI applications and the potential PPP. The strong profit growth should also enable ROE to expand from 24% in 2016 to 28%/30% in 2017/18, respectively. Risks: market share loss and weak demand.

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	10,078	13,329	18,350	25,000	33,033
DB EPS FD(CNY)	0.48	0.63	0.91	1.24	1.62
% Change	0.0%	0.0%	5.5%	15.3%	20.4%

Source: Deutsche Bank estimates, company data



Model updated: 21 July 2017

Running the numbers

Asia
 China
 Hardware & Equipment

Dahua

Reuters: 002236.SZ Bloomberg: 002236 CH

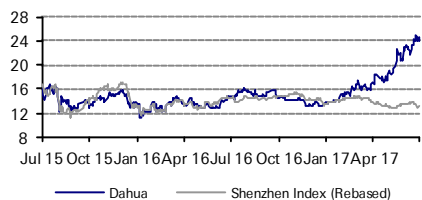
Buy

Price (21 Jul 17) CNY 24.03
 Target Price CNY 27.30
 52 Week range CNY 13.16 - 24.91
 Market Cap (m) CNYm 68,854
 USDm 10,175

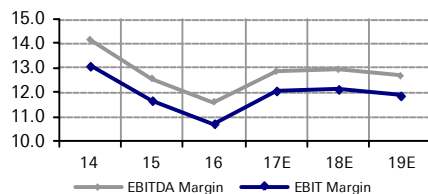
Company Profile

Zhejiang Dahua Technology Co., Ltd. researches, designs and manufactures security and surveillance equipments. It also modular-designs both hardware and software with flexibility for different configurations, various scales of applications and future expansion.

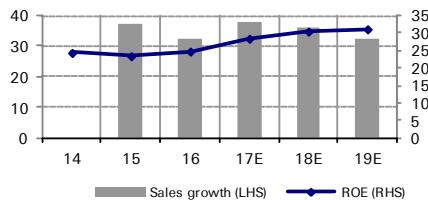
Price Performance



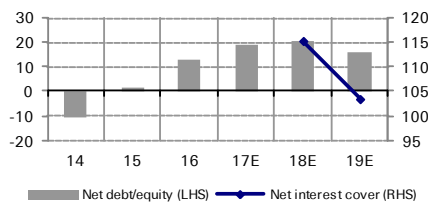
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.40	0.48	0.63	0.91	1.24	1.62
Reported EPS (CNY)	0.40	0.48	0.63	0.91	1.24	1.62
DPS (CNY)	0.04	0.08	0.10	0.18	0.25	0.32
BVPS (CNY)	1.8	2.3	2.8	3.6	4.6	5.9
Weighted average shares (m)	2,865	2,865	2,899	2,899	2,899	2,899
Average market cap (CNYm)	31,608	40,169	40,394	68,854	68,854	68,854
Enterprise value (CNYm)	30,988	40,269	41,402	70,772	71,583	71,546

Valuation Metrics

P/E (DB) (x)	27.7	29.3	22.1	26.3	19.4	14.8
P/E (Reported) (x)	27.7	29.3	22.1	26.3	19.4	14.8
P/BV (x)	4.80	6.47	4.81	6.73	5.27	4.10
FCF Yield (%)	nm	nm	nm	nm	nm	1.5
Dividend Yield (%)	0.4	0.6	0.7	0.8	1.0	1.4
EV/Sales (x)	4.2	4.0	3.1	3.9	2.9	2.2
EV/EBITDA (x)	29.8	31.8	26.7	30.0	22.1	17.1
EV/EBIT (x)	32.3	34.2	29.0	31.9	23.6	18.2

Income Statement (CNYm)

Sales revenue	7,332	10,078	13,329	18,350	25,000	33,033
Gross profit	2,875	3,842	5,144	7,111	9,585	12,339
EBITDA	1,039	1,268	1,548	2,361	3,236	4,188
Depreciation	74	85	106	133	189	254
Amortisation	5	6	12	12	12	12
EBIT	960	1,176	1,430	2,216	3,034	3,922
Net interest income/(expense)	26	28	14	13	-26	-38
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	267	373	569	791	1,085	1,440
Profit before tax	1,253	1,578	2,012	3,020	4,093	5,323
Income tax expense	109	197	202	336	457	578
Minorities	2	9	-15	40	40	40
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	1,143	1,372	1,825	2,644	3,596	4,705
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	1,143	1,372	1,825	2,644	3,596	4,705

Cash Flow (CNYm)

Cash flow from operations	-777	-3	-80	277	669	1,845
Net Capex	-128	-368	-564	-600	-700	-805
Free cash flow	-905	-371	-644	-323	-31	1,040
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-117	-232	-290	-529	-719	-941
Net inc/(dec) in borrowings	460	1,104	1,363	-655	500	0
Other investing/financing cash flows	57	-62	-56	-55	-57	-58
Net cash flow	-505	439	374	-1,562	-307	40
Change in working capital	-1,998	-1,467	-2,023	-2,513	-3,128	-3,127

Balance Sheet (CNYm)

Cash and other liquid assets	1,263	1,701	2,075	513	206	247
Tangible fixed assets	716	857	1,055	1,521	2,032	2,583
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	54	65	261	261	261	261
Other assets	5,957	8,880	11,975	15,869	21,290	27,436
Total assets	7,990	11,503	15,366	18,165	23,790	30,527
Interest bearing debt	688	1,792	3,155	2,500	3,000	3,000
Other liabilities	2,091	3,145	3,785	5,124	7,372	10,345
Total liabilities	2,779	4,937	6,941	7,624	10,372	13,345
Shareholders' equity	5,203	6,492	8,237	10,349	13,222	16,982
Minorities	8	74	189	193	196	200
Total shareholders' equity	5,211	6,566	8,426	10,541	13,418	17,182
Net debt	-575	90	1,080	1,987	2,794	2,753

Key Company Metrics

Sales growth (%)	nm	37.5	32.3	37.7	36.2	32.1
DB EPS growth (%)	na	20.1	31.5	44.9	36.0	30.8
EBITDA Margin (%)	14.2	12.6	11.6	12.9	12.9	12.7
EBIT Margin (%)	13.1	11.7	10.7	12.1	12.1	11.9
Payout ratio (%)	10.2	16.9	15.9	20.0	20.0	20.0
ROE (%)	24.4	23.5	24.8	28.5	30.5	31.2
Capex/sales (%)	1.8	3.7	4.2	3.3	2.8	2.4
Capex/depreciation (x)	1.6	4.0	4.8	4.1	3.5	3.0
Net debt/equity (%)	-11.0	1.4	12.8	18.8	20.8	16.0
Net interest cover (x)	nm	nm	nm	nm	115.3	103.5

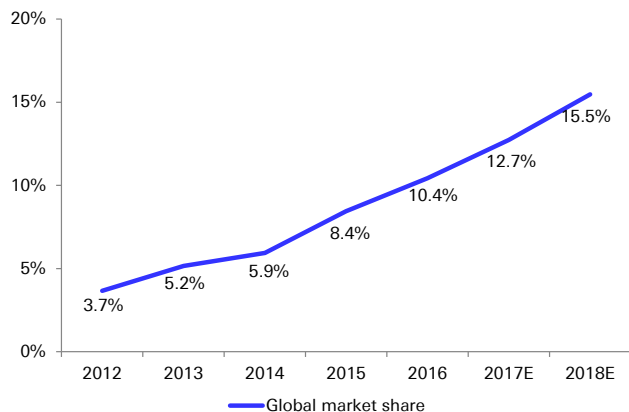
Source: Company data, Deutsche Bank estimates



Valuation and risks

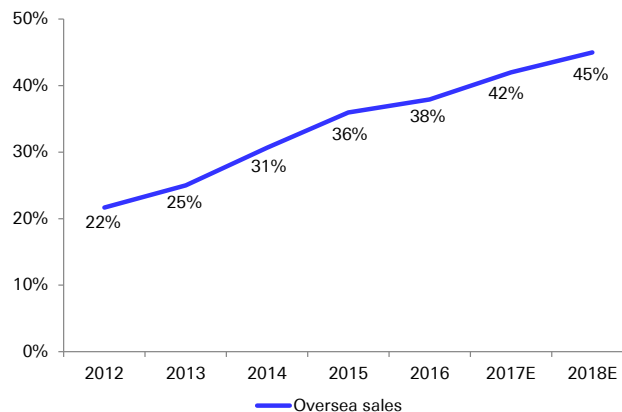
Maintain Buy rating with 12-month target price of CNY27.3

Figure 1: Dahua's global market share



Source: Deutsche Bank estimates

Figure 2: Dahua's overseas sales



Source: Deutsche Bank estimates

We raise our 2017-19 earnings forecasts by 5-16% to reflect the accelerated profit growth supported by the rising AI application contributions and the potential PPP project. We now estimate profit growth will accelerate to 45%/36%/31% in 2017/2018/2019E, respectively. The strong profit growth should also enable ROE to expand from 24% in 2016 to 28%/30%/31% in 2017/2018/2019E, respectively.

We raise our TP from CNY19.4 to CNY27.3 and expand our target P/E multiple from 20x 2H17-1H18 to 22x 2018E due to Dahua's accelerated profit growth and ROE expansion. Our 2017 and 2018 EPS forecasts are 6% and 9% higher than Bloomberg consensus. We retain our Buy rating.

Figure 3: Shache country PPP project

PPP project	2017E	2018E	2019E
Earnings contribution	3%	10%	<1%

Source: Deutsche Bank estimates



Figure 4: Earnings revisions

P/L Revision (CNY mn)	2016	2017E		2018E		2019E		% of change		
	(Actual)	Old	New	Old	New	Old	New	2017E	2018E	2019E
Net sales	13,329	17,162	18,350	21,574	25,000	26,200	33,033	6.9	15.9	26.1
Gross profit	5,026	6,514	6,965	7,998	9,383	9,701	12,072	6.9	17.3	24.4
Operating expense	3,596	4,442	4,749	5,430	6,349	6,475	8,151	6.9	16.9	25.9
Operating profit	1,430	2,072	2,216	2,568	3,034	3,226	3,922	6.9	18.2	21.6
Non-op gain/loss	582	752	804	950	1,058	1,169	1,402	6.9	11.4	19.9
Pre-tax profit	2,012	2,824	3,020	3,518	4,093	4,395	5,323	6.9	16.3	21.1
Net profit	1,825	2,506	2,644	3,144	3,596	3,939	4,705	5.5	14.4	19.4
EPS (CNY)	0.6	0.9	0.9	1.1	1.2	1.4	1.6	6.1	13.8	15.9
Key ratio (%)										
Sales growth	32.3	28.8	37.7	25.7	36.2	21.4	32.1			
Gross margin	37.7	38.0	38.0	37.1	37.5	37.0	36.5			
Operating Margin	10.7	12.1	12.1	11.9	12.1	12.3	11.9			
Net margin	13.7	14.6	14.4	14.6	14.4	15.0	14.2			

Source: Deutsche Bank estimates, company data

Figure 5: Valuation comparison table

Ticker	Name	PX_Last (local cur.)	Mkt cap (US\$m)	DB cover.	EPS		P/E		EPS YoY		BVPS		P/B		ROE		DPS	
					2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
Video Surveillance																		
002415 CH	Hikvision Digital	30.0	41,851	Buy	1.5	1.9	20	16	23%	23%	4.6	5.6	6.5	5.4	36%	37%	0.7	0.9
002236 CH	Dahua Technology	24.4	10,328	Buy	0.9	1.2	27	20	37%	24%	3.5	4.4	6.9	5.5	27%	27%	0.2	0.2
300367 CH	NetPosa Technology	15.8	2,080	NR	0.6	0.8	27	19	42%	39%	4.1	4.7	3.8	3.3	13%	15%	0.0	0.1
300449 CH	Hanbang Technology	26.9	572	NR	0.6	0.9	43	30	123%	41%	5.2	5.9	5.2	4.6	12%	15%	0.1	0.2
FLIR US	FLIR Systems	38.4	5,202	NR	1.9	2.1	21	19	52%	11%	13.0	13.8	3.0	2.8	14%	14%	0.6	0.6
Average							27	21	56%	28%			5.1	4.3	20%	21%		

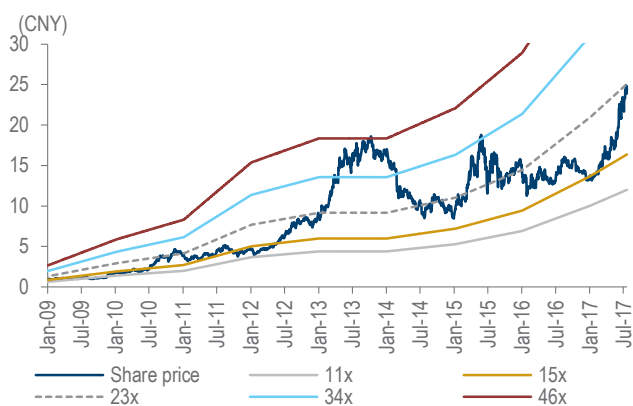
Source: Deutsche Bank

Downside risks

- Slower orders for video surveillance products and solution business could result in downside risks to Dahua's revenue and earnings growth vs. our assumptions.
- Weaker ODM orders from globally leading brand vendors would negatively impact sales and OPM performance.
- Higher costs for components, labor, and factory management in China

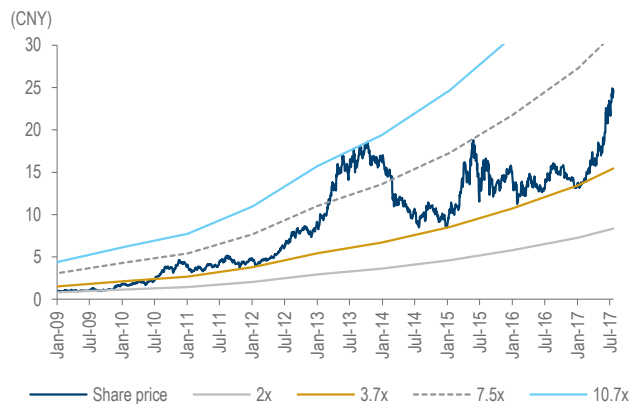


Figure 6: 12-month forward P/E band



Source: Deutsche Bank; TEJ

Figure 7: 12-month forward P/B band



Source: Deutsche Bank; TEJ

Figure 8: Quarterly P&L highlights

(CNY mn)	1Q17	2Q17E	3Q17E	4Q17E	2017	1Q18E	2Q18E	3Q18E	4Q18E	2018E
Sales	2,649	4,432	4,267	7,002	18,350	3,652	6,065	5,912	9,372	25,000
Gross profit	1,053	1,693	1,615	2,604	6,965	1,440	2,314	2,188	3,441	9,383
Operating profit	145	616	356	1,098	2,216	199	889	474	1,473	3,034
Non-operating item	163	196	189	256	804	150	257	250	401	1,058
Pre-tax income	308	812	545	1,355	3,020	349	1,146	724	1,873	4,093
Net profit	287	707	501	1,150	2,644	325	1,006	658	1,607	3,596
EPS (CNY)	0.10	0.24	0.17	0.40	0.91	0.11	0.35	0.23	0.55	1.24
Margin Analysis (%)										
Gross margin	39.7	38.2	37.9	37.2	38.0	39.4	38.2	37.0	36.7	37.5
Operating margin	5.5	13.9	8.4	15.7	12.1	5.4	14.7	8.0	15.7	12.1
Pre-tax margin	11.6	18.3	12.8	19.3	16.5	9.6	18.9	12.3	20.0	16.4
Tax rate	6.9	12.9	8.2	15.1	12.4	6.9	12.2	9.1	14.2	12.1
YoY growth (%)										
Sales	48.6	40.7	41.4	30.2	37.7	37.9	36.9	38.5	33.8	36.2
Gross profit	52.6	41.7	38.2	32.0	38.6	36.8	36.7	35.5	32.1	34.7
Operating profit	39.4	37.6	70.5	64.2	55.0	37.1	44.3	33.0	34.1	36.9
Pre-tax profit	25.8	42.0	68.9	55.2	50.1	13.2	41.1	32.9	38.3	35.5
Net profit	33.3	43.0	39.1	52.1	44.9	13.3	42.2	31.5	39.8	36.0
QoQ growth (%)										
Sales	-50.8	67.3	-3.7	64.1		-47.9	66.1	-2.5	58.5	
Gross profit	-46.6	60.8	-4.6	61.2		-44.7	60.7	-5.4	57.2	
Operating profit	-78.3	325.1	-42.1	208.1		-81.9	347.4	-46.7	210.6	
Pre-tax profit	-64.7	163.4	-32.9	148.6		-74.2	228.3	-36.8	158.7	
Net profit	-62.0	146.6	-29.2	129.7		-71.7	209.6	-34.6	144.2	
Sales breakdown										
Front-end Audio / Video Products	49%	49%	53%	54%	52%	51%	52%	56%	57%	55%
Back-end Audio / Video Products	26%	26%	32%	34%	30%	23%	23%	28%	31%	27%
Central Controlling Equipment	4%	4%	7%	5%	5%	3%	3%	5%	4%	4%
Others	21%	21%	9%	7%	13%	22%	22%	11%	8%	14%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Deutsche Bank estimates, company data



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Dahua	002236.SZ	24.03 (CNY) 21 Jul 17	NA

Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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Historical recommendations and target price: Dahua (002236.SZ)

(as of 7/21/2017)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

**Analyst is no longer at Deutsche Bank

1. 20/09/2015: Upgrade to Buy, Target Price Change CNY36.00 Andrew-C Chang**	3. 15/11/2016: Upgrade to Buy, Target Price Change CNY17.30 Janice Cheng
2. 28/04/2016: No Recommendation, Target Price Change CNY0.00 Andrew-C Chang**	4. 25/04/2017: Buy, Target Price Change CNY19.40 Janice Cheng



Equity rating key

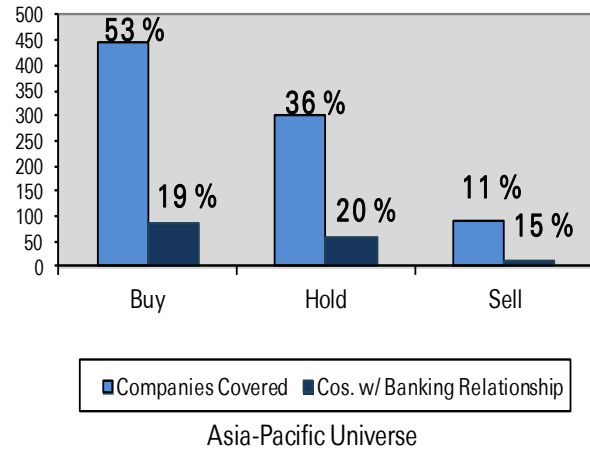
Buy: Based on a current 12-month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

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.

Equity rating dispersion and banking relationships





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