JCAP

Survey China

April 7, 2016

Tim Murray
+852 2534 7405
tim@jcapitalresearch.com

Survey Structure

- Survey of 10 elevator sales companies. 5 distributors and 5 manufacturers regional sales company. Located in South China (4), East China (3), West China (1), North China (1) and Northeast China (1). We have an intentional bias to the larger and comparatively stronger market of East and South China.
- Annual sales of the surveyed companies total 11,375 elevators or approximately 2% of the China market.
- Sample bias to market leader Kone
- Repeat sources: All
- Interviews June 12 – 15

Objectives

- To understand elevator orders in Q1 2015, sales outlook for Q2 2016 and changes in the market and competition environment.

Companies

- Kone, Untied Technologies (Otis), Hitachi, Mitsubishi Electric, ThyssenKrupp, Schindler

Elevator Survey Q1 2016

Orders down 5-8% in Q1 2016

- **Kone orders are down 5-8%** on a unit basis in Q4 based on our sample.
- **The outlook for Q2 orders is up 3%** but for the second half overall still down 2-3% YoY
- **Regional variation in real estate markets** is reflected in the wide variation in elevator order and sales performance. Tier 1 and 2 cities are outperforming lower tier cities.
- **Orders in Guangdong Province** have seen the best growth. We estimate Kone sales are up 10% in the province. An improving property market is cited as the key reason.
- **Orders in Jinan** are up. In that Shandong city, compensation to residents of land being redeveloped is now being paid in cash instead of in kind, and these people are using cash to buy available inventory in the market. The vacant land is then sold on to commercial developers.
- **Orders in the important construction market** of East China are falling by more than 20%
- **Kone prices are continuing to fall** 5–10% in some regions.
- **Kone direct sales to larger developers** continue to outperform the market by around 10%.
- **The trend to lower-priced products continues,** and orders are being placed later.
- **Kone appears to be outperforming** competitors and the market.

Real Estate Market Regional Variation

Real estate sales have been stronger in Tier 1 and 2 cities and weaker in lower tier cities. Where lower tier cities are adjacent to Tier 1 and 2 cities and new transport infrastructure such as light rail or high speed rail makes commuting times shorter then these cities real estate markets are more like those in Tier 1 and 2 cities. Tier 1 cities real estate market have been so strong there are now new restrictions on property purchase by non-residents. Tier 2 cities have reduced restrictions on non-residents and in some cases allow them to become residents. This has created stronger demand for property in Tier 2 cities.

Elevator orders were weak in East China.

In our survey we found Shandong province has good elevator orders and this is reflected in strong new starts and completions in that province. Elevator orders were weak in East China and new starts in the key provinces of Jiangsu and Zhejiang were low. Guangdong elevator sales were strong and Fujian weak in the survey. Both provinces have negative growth in new starts but strong growth in completions. Government programs to give cash rather than apartments to people being relocated, as part of the "shanty town" redevelopment program are planned to increase this year. We saw evidence of this in our survey in Jinan. The idea is that relocated residents use cash to buy existing inventory and the land is sold to commercial developers.

Table 1. Residential Construction Floor Space 2016

	Share of National Construction Market	New Starts Feb YTD	Completions Feb YTD
Fujian	3%	-3%	120%
Guangdong	4%	-2%	42%
Jiangsu	9%	5%	4%
Zhejiang	4%	1%	65%
Shandong	6%	23%	52%

Source: Wind

Tim Murray +852 2534 7405 tim@jcapitalresearch.com

April 7, 2016

Table 2. Elevator Orders and Outlook

Region/Tier/ Units/Brand	Orders 1Q 2016 YoY	Q1 2016 Why?	Orders Q4 2015 YoY	Q2 2016 Outlook	Q2 2016 Why?
East China Tier 2 1,000 Giant Kone	10%	Projects left over from last year finally signed.	-30%	25%	We have a few big projects that we will sign up. Target for the year is no increase in orders over 2015.
East China Tier 3 500 Kone	-20%	Developers are delaying orders. Orders were hot at the end of last year and now they are not.	30%	-40%	Very little interest in Q1, nationally the H1 is poor, only the Tier 1 and Tier 2 cities are good.
East China Tier 3 300 Kone	-50%	Poor demand from developers	-20%	-15%	Expecting a bit of a sales surge in 2Q but still not better than last year.
North East China Tier 2 850 Kone	-20%	Property developers worse than last year	-50%	Flat	Improvement on 1Q
North China Tier 2 700 Giant Kone	35%	Lots of new projects starting. The market is back this quarter.	-50%	-25%	2Q 15 had a large order, still expecting 30% increase this year. We are giving cash incentives to agents for achieving volume targets.
West China Tier 2 350 Hitachi	Flat	Good relations with local developers	-20%	20%	Have a large project we should sign.
South China Tier 2 and 3 7,000 Giant Kone Otis	-20%	Almost no new buildings in T2 City, to much inventory is lower tier cities, construction slow, developers poor finance	Flat	Flat	Old customer placing orders, orders left over from last year. Lower tier cities have poor demand.
South China Tier 1 1500 Kone	10%	New mid size developers became strategic partners.	Flat	10%	2Q and 3Q are peak periods for construction.

April 7, 2016

Region/Tier/ Units/Brand	Orders 1Q 2016 YoY	Q1 2016 Why?	Orders Q4 2015 YoY	Q2 2016 Outlook	Q2 2016 Why?
South China Tier 1 500 80% Hitachi 20% 5 other top brands	45%	Orders coming in from projects started last year.	10%	30%	Good strategic partner sales and peak season.
South China Tier 3 600 Otis	5%	Good sales in new districts	Flat	30%	Property developers are improving, new districts, government infrastructure projects.
South China Tier 3 600 Otis	5%	Good sales in new districts	Flat	30%	Property developers are improving, new districts, government infrastructure projects.

Table 3. Composition of Sales

Region/Tier/Units/ Brand	Manf Direct Sales Share	Manf Direct Sales Growth	Service Market	Change in Product Composition
East China Tier 2 1,000 Giant Kone	5%	Down 10%	Flat, profit is less than 5%	No change, focused on low end.
East China Tier 3 500 Kone	60%	Growth is better by around 10%.	Maintenance is 5% of revenue, manufacturer retains 70% -80% of clients. Price of contracts falling.	Low-end product growth significantly better as affordable housing segment is growing
East China Tier 3 300 Kone	60%	Growth 10-15% order deposit only 5%	Flat, profitable	Low end elevator market share up 20%
North East China Tier 2 850 Kone	50%	Growth 10%, Sales of national developers are much better than local private developers	Flat sales break even.	Same as last year, low end 20%, Mid 60% and High 20%.
North China Tier 2 700 Giant Kone	30%	Direct sales to national developers are growing and market share is up from 20%.	Increased significantly due to free service in first year. In the past half had to pay. Maintenance makes no profit now.	Low end products remain the core of sales.

April 7, 2016

Region/Tier/Units/Brand	Manf Direct Sales Share	Manf Direct Sales Growth	Service Market	Change in Product Composition
West China Tier 2 350 Hitachi	40%	Flat for Kone, Hitachi and Kangli	Increased 30% and profitable	No change
South China Tier 2 and 3 7,000 Giant Kone Otis	40%	Many projects have halted, Manufactures using price to compete for sales.	Flat sales and profit margin has fallen 2 – 3%.	High end products now have a much smaller price difference.
South China Tier 1 1500 Kone	60%	Same as market	Flat, profitable	No Change
South China Tier 1 500 80% Hitachi 20% 5 other top brands	40%	Flat (was increasing last year)	Service contracts growing well and profitable	
South China Tier 3 600 Otis	50%	Distributor sales are better, direct sales are to larger projects	Service market is good we are getting a lot of refurbishment sales.	Elevator manufactures are reducing the specifications of equipment as they lower price

Table 4. Market Conditions

Region/Tier/Units/Brand	Demand Segments	Placing Ordering Time	Order Delay	Accounts Receivable Change	Price Change	Competitors
East China Tier 2 1,000 Giant Kone	Residential good, retail is now good (improved over last quarter). Government buildings like airports and hospitals are not good.	Late	Normal	20% of clients pay last 20% late 6 months. (improved over last quarter)	No change as down 10% end of last year	Local brands sales are contracting.
East China Tier 3 500 Kone	Non-Residential very low demand. Social housing is good.	Very Late	30-40% are delayed no change	Final 20% payment delayed 4-5 months. 3 cases went to court		The market is contracting and no one is doing well.

Tim Murray +852 2534 7405 tim@jcapitalresearch.com
See final page for disclaimers.

Region/Tier/ Units/Brand	Demand Segments	Placing Ordering Time	Order Delay	Accounts Receivable Change	Price Change	Competitors
East China Tier 3 300 Kone	Residential is about 50% of sales. Government public buildings demand is declining.	Very Late	30-40% delayed no change on last year	Last 20% is now overdue for up to 12 months. Lower ties cities the worst		ThyssenKrupp and Schindler doing better. Similar domestic products are taking market share with price points 10% cheaper. Hitachi sales fell 30-40% last year. Their product not changing fast enough for the market.
North East China Tier 2 850 Kone	Shopping centers, office buildings and infrastructure are all growing, but our largest channel residential is contracting.	Very Late	30% delayed, customers are waiting to the very last minute to take delivery.	Excellent		ThyssenKrupp is up 20% in Q1 as they signed up two large projects and had poor sales last year.
North China Tier 2 700 Giant Kone	Residential is relatively good, very few shopping malls and office buildings. (deteriorated)	Extremely Late	100% of orders delayed. Lots of projects halted at the end of last year. (deteriorated)	Distributors now getting easier credit terms. 20% of payment can be paid after 3 months. Some direct customers in arears for 2 months.	Price is down 5 – 7% (RMB5,500 to 6,000) average price is now RMB100,000.	Hitachi and Kone, direct sales are 50-60% of sales. Local brands such as Kangli, Hangzhou Xiao, Dongzhi and Yongda are not selling as well as Giant Kone.
West China Tier 2 350 Hitachi	Residential	Normal	Normal	Now 50% of sales have 90 days overdue (worse)		Kone sales are the best but as the market is contracting that is bad for them. Otis and Schindler are selling to metro projects. Domestic brands like Kangli have weaker sales.

April 7, 2016

Region/Tier/ Units/Brand	Demand Segments	Placing Ordering Time	Order Delay	Accounts Receivable Change	Price Change	Competitors
South China Tier 2 and 3 7,000 Giant Kone Otis	Mid tier property developer brand is improving, Low end finding it hard to exist.	Extremely Late Developers are struggling to get bank loans.	100% delayed up from 70%	Getting progressively worse.	Down 5 – 10%	Kone brand has been doing well. Lower prices have been key to sales. Otis is doing poorly and is not developing new distributors.
South China Tier 1 1,500 Kone	Residential is best, high end office and shopping mall, Infrastructure flat	Normal	Normal	Normal	Down 5%	Domestic brands like Kangli, Jiati, and Shenlong are doing well and growing 5 – 10%. They have lower prices than the foreign brands. As the real estate sector is not doing well we expect some of the weaker domestic brands will go out of business.
South China Tier 1 500 80% Hitachi 20% 5 other top brands	Low end residential is not doing well, everything else is doing okay	Very Late	Normal	Normal	Down	Kone and Hitachi doing well as their pricing is more competitive than similar brands. These brands increased 15% in 1Q 2016. Schindler and ThyssenKrupp are too expensive and not selling well.
South China Tier 3 600 Otis	High end residential, office and retail are doing well.	Very Late	Now 60% delayed and increasing	Last 20% is now late by 3 months for most clients.		Kone and Hitachi doing well as they have low prices and better payment terms. Fujitsu and Schindler are not doing well. Schindler has poor maintenance.

Tim Murray +852 2534 7405 tim@jcapitalresearch.com

Notable Quotes

"All the companies in the elevator industry have hit hard times. We are a little more positive at the moment but the first half will still be down. Maybe the second half will pick up." East China

"We remain conservative about the outlook. The real estate market in Tier 3 cities is not coming back, apartments are just not selling, and there is no increase in the population. Demand is very low." East China

"Our sales in the first half will be flat on last year. There is no way there will be an increase on last year. Not getting worse is already great." North East China

"Real estate is coming back a little with growth in the first half of 2016 up 5–10% YoY. The government social housing construction is coming to an end. We rely on the low end and so that is negative for us." East China

"This will be a good year as the real estate market is coming back. Our sales are much, much better than last year even though there is still a lot of inventory in the market. The government has a new policy that has been very positive for the market. The district of Penghu in Jinan is being redeveloped and instead of giving the people that are being relocated a social housing unit they are giving them cash. This has been great for reducing inventory in the city. This year there are a lot of new starts, and a lot of the projects halted last year have restarted. " North China

"Everyone is negative about the market, we all expect sales to fall" West China.

"From speaking with elevator manufacturers, clients and our own sales, I can say clearly that 1H 2016 the construction market will be down significantly" South China

"The construction market in the first half of 2016 is stronger than the first half of 2015. Real estate sales are strong." South China

"In half 1 2016 the construction market is improving and orders are better than 2015.

"In Fujian the good selling areas like downtown Xiamen have no supply, and in the lower tier cities there is lots of inventory but no buyers. So we want to diversify away from property developers." South China

Disclaimer

This publication is prepared by J Capital Research Limited ("J Capital"), a Hong Kong registered company. J Capital is regulated as a company advising on securities by the Hong Kong Securities and Futures Commission (CE# AYS956) and is registered as an investment adviser with the U.S. SEC (CRD# 165324). This publication is distributed solely to authorized recipients and clients of J Capital for their general use in accordance with the terms and conditions of a Services Agreement and the J Capital Authorized User Content Agreement available here. Unauthorized copying or distribution is prohibited. If you are reading this publication without having entered into a Services Agreement with J Capital, or having received written authorization to do so, you hereby agree to be bound by the J Capital Non-Authorized User Content Agreement that can be viewed here. J Capital does not do business with companies covered in its publications, and nothing in this publication should be construed as a solicitation to buy or sell any security or product. In preparing this document, J Capital did not take into account the investment objectives, financial situation and particular needs of the reader. This publication is intended by J Capital only to be used by investment professionals. Before making an investment decision, the reader needs to consider, with or without the assistance of an adviser, whether the contents are appropriate in light of their particular investment needs, objectives and financial circumstances. J Capital accepts no liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this publication and/or further communication in relation to this document.

Tim Murray +852 2534 7405 tim@jcapitalresearch.com