

## Zoomlion Heavy Industry - A (000157 CH)

### Stock ownership plan to offer strong incentive to management

**What's new?** We believe the stock ownership plan that announced last Friday will offer strong motivation to the management and key employees to deliver sustainable earnings growth over the next three years, which should more than offset the share incentive expense arising from this. We maintain our TP of RMB7.28 (based on 1.4x 2019E P/B, on the back of 12%-13% ROE in 2019E-21E). Reiterate **BUY**.

■ **Details of the stock ownership plan.** The participants include the core management and key employees in the Company, with a maximum of 1,200 employees. The purchase price is set at RMB2.75 per share. The lock-up period is divided into three stages, with 40%, 30% and 30% of the shares to be unlocked in 2020E, 2021E and 2022E respectively, subject to Zoomlion's net profit targets during the period. Either of the following two criteria has to be satisfied for each of the year: (1) In 2020/ 21/ 22, the net profit growth to be no less than 80%/90%/100%, compared with the Benchmark (Benchmark = average net profit in 2017-19); (2) the total net profit in 2020-21 to grow 170% from the Benchmark, and the total net profit in 2020-22 to grow 270% from the Benchmark (Figure 1). The stock ownership plan is subject to the approval by shareholders in EGM.

■ **Higher expense but higher employee incentive.** Given that the underlying shares of the stock ownership plan are the 390mn A shares (4.96% of total o/s shares) the Company repurchased in 2Q19 (average price: RMB5.49), we calculate that the total share incentive expense to Zoomlion to be RMB1bn in 2020E-22E. That's said, we believe the discount on purchase price (RMB2.75) is attractive to the participants, offering strong incentive.

■ **Investment in agricultural machinery segment.** Zoomlion plans to invest RMB2.05bn in 2020-25 (annual capex: RMB342mn) in the intelligent agriculture machinery business in Wuhu. While the industry has been on a downcycle, Zoomlion expects the favourable government policy to support the upgrade of agriculture machinery will offer new opportunities. In 2018/1H19, revenue from agricultural machinery accounted for only 5%/4% of the total revenue. Zoomlion targets to achieve breakeven this year versus a loss in 2018. We fine-tuned our 2020E-21E earnings forecast by -0.5%/-0.5% after incorporating the capex but have not modelled growth in this segment. Any improvement will offer upside to our existing forecast.

#### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	20,608	28,697	44,342	50,749	54,824
YoY growth (%)	2.9	39.3	54.5	14.4	8.0
Net income (RMB mn)	1,342	2,031	4,551	5,321	5,719
EPS (RMB)	0.18	0.27	0.58	0.68	0.73
YoY growth (%)	n/a	51.5	118.6	16.6	7.5
EV/EBITDA (x)	n/a	13.5	7.5	6.7	6.4
P/E (x)	31.8	21.7	10.2	8.8	8.1
P/B (x)	1.2	1.2	1.2	1.1	1.0
Yield (%)	3.6	4.3	5.9	6.9	7.4
ROE (%)	3.6	5.4	11.9	13.2	13.1
Net gearing (%)	39.6	33.6	33.2	23.0	15.0

Source: Company data, CMBIS estimates

**BUY (Maintain)**

Target Price	RMB7.28
(Previous TP)	RMB7.28)
Up/Downside	+22%
Current Price	RMB5.99

#### China Capital Goods

**Wayne Fung, CFA**

(852) 3900 0826

waynefung@cmbi.com.hk

#### Stock Data

Mkt Cap (RMB mn)	46,573
Avg 3 mths t/o (RMB mn)	221
52w High/Low (RMB)	6.47/3.45
Total Issued Shares (mn)	<b>6,456 (A)</b> 1,388 (H)

Source: Bloomberg

#### Shareholding Structure

SASAC of Hunan Province	16.0%
Management team	4.9%
A share free float	61.4%
H share free float	17.7%

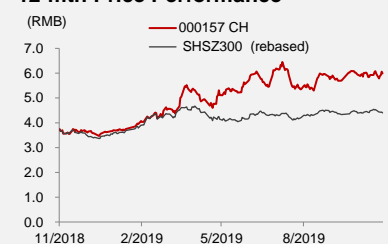
Source: HKEx, Shanghai Stock Exchange

#### Share Performance

	Absolute	Relative
1-mth	+0.2%	+1.4%
3-mth	+12.0%	+7.2%
6-mth	+17.0%	+10.1%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

**Auditor: KPMG**

#### Related Reports

- Zoomlion (000157 CH, BUY) – Raising earnings estimates on surprising strong 3Q19 profit – 15 Oct 2019
- Zoomlion (000157 CH, BUY) - Net profit +196% YoY in 1H19 within expectations – 2 Sep 2019
- Zoomlion (000157 CH, BUY) – 2Q19 Earnings above expectations; Initiate with BUY – 15 Jul 2019

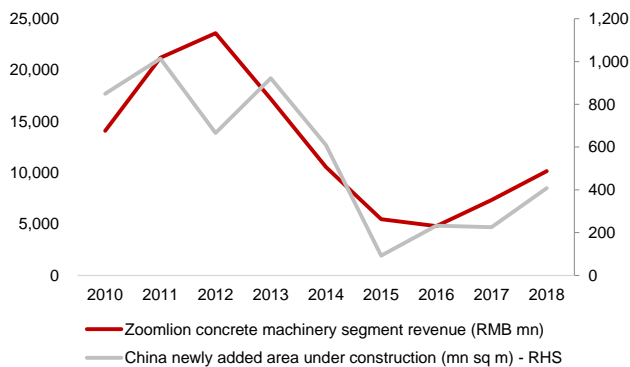
**Figure 1: Stock incentive plan and estimated expense**

	2017	2018	2019E	2020E	2021E	2022E
(RMB mn)						
Net profit (CMBI estimates)	1,342	2,031	4,551	5,321	5,719	-
Average net profit in 2017-19E (Benchmark for the calculation of performance)			2,641			
<b>Performance target (either A or B)</b>						
<b>(A)</b>				<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Net profit growth compared with the Benchmark				80%	90%	100%
<b>Net profit target (RMB mn)</b>				<b>4,755</b>	<b>5,019</b>	<b>5,283</b>
<b>(B)</b>				<b>2020E-21E</b>	<b>2020E-22E</b>	
Accumulated net profit growth compared with the Benchmark				-	170%	270%
<b>Accumulated net profit target (RMB mn)</b>				<b>-</b>	<b>7,132</b>	<b>9,773</b>
<b>Unlock period</b>				<b>1st</b>	<b>2nd</b>	<b>3rd</b>
% of total shares to be unlocked under the stock ownership plan				40%	30%	30%

<b>Calculation of the share incentive expense</b>	
Number of A-shares repurchased for the stock ownership plan (mn)	390
Repurchased price (RMB per share)	5.49
Exercise price of the stock ownership plan (RMB per share)	2.75
Total amount spent on repurchase (RMB mn)	2,144
Maximum fund raised from the stock ownership plan (RMB mn)	1,074
<b>Total share incentive expense in 2020E-22E (RMB mn)</b>	<b>1,070</b>

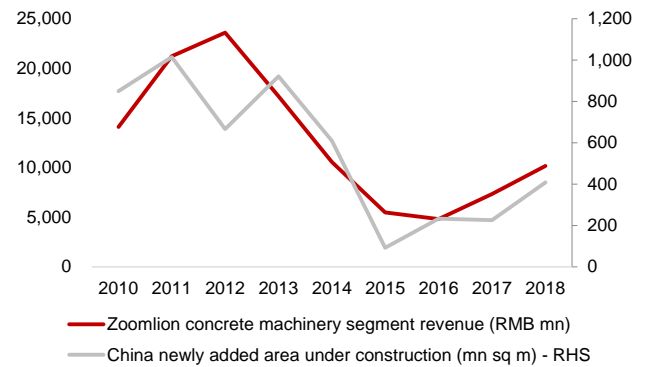
Source: Company data, CMBIS estimates

**Figure 2: China tower crane sales vs China newly added property area under construction**



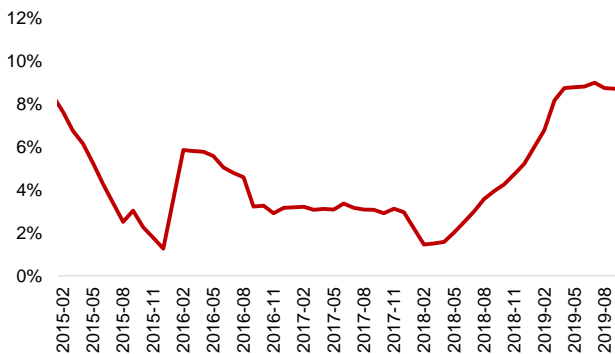
Source: NBS, CCMA, Wind, CMBIS

**Figure 3: Zoomlion concrete machinery sales vs China newly added area under construction**



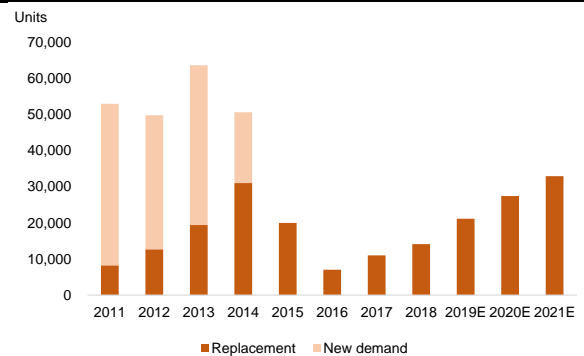
Source: NBS, Wind, Company data, CMBIS

**Figure 4: China monthly property area under construction growth (YoY)**



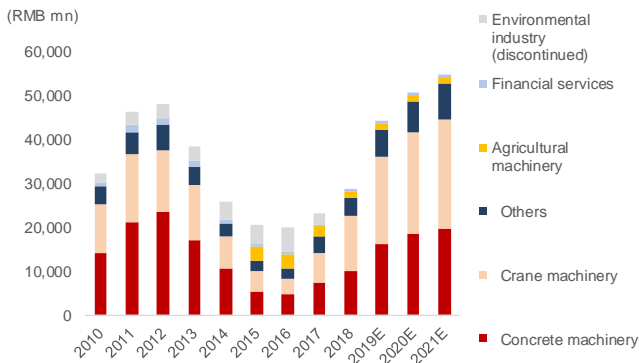
Source: NBS, Wind, CMBIS

**Figure 5: CMBI forecast on China tower crane sales volume**



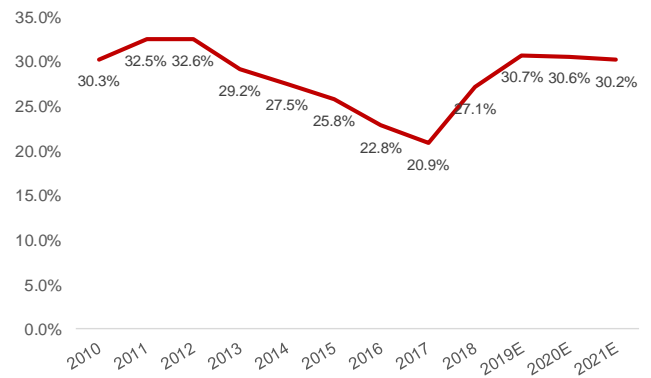
Source: CCMA, CMBIS estimates

**Figure 6: Zoomlion's revenue trend**



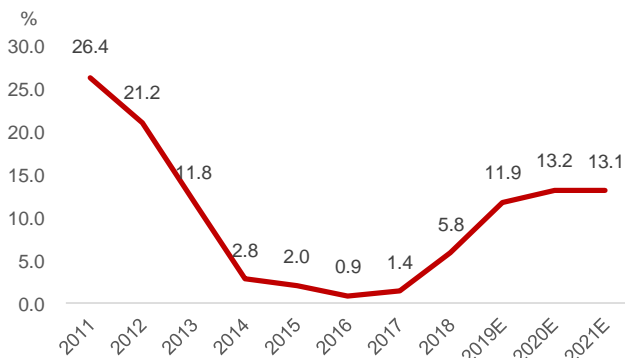
Source: Company data, CMBIS estimates

**Figure 7: Zoomlion's gross margin trend**



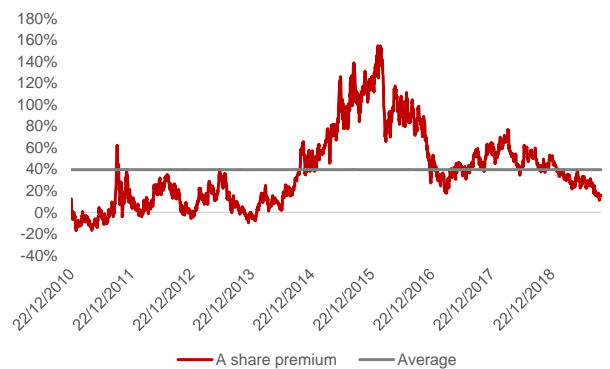
Source: Company data, CMBIS estimates

**Figure 8: Zoomlion's ROE trend**



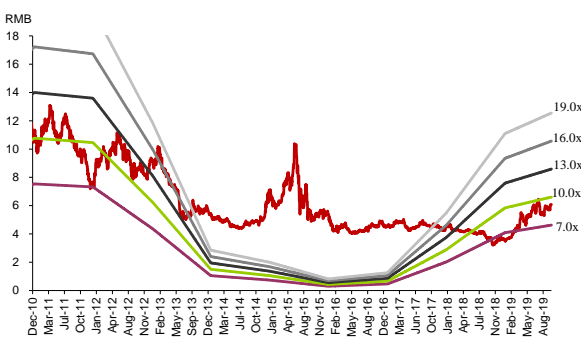
Source: Company data, CMBIS estimates

**Figure 9: Zoomlion A share premium to H share**



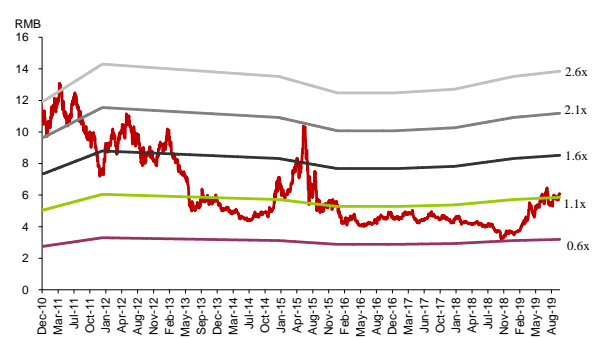
Source: Bloomberg, CMBIS

**Figure 10: Zoomlion - A 12M forward P/E band**



Source: Bloomberg, Company data, CMBIS estimates

**Figure 11: Zoomlion - A 12M forward P/B band**



Source: Bloomberg, Company data, CMBIS estimates

**Key catalysts:** Rising infrastructure spending, resilient growth of property area under construction, replacement of national emission standard (NES) III trucks, and market share gain on tower crane and concrete machinery will all serve as share price catalysts.

**Risk factors:** (1) Unexpected weakness on property construction activities; (2) Slow recovery of infrastructure spending; (3) High earnings volatility.

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Total revenue</b>	<b>20,608</b>	<b>28,697</b>	<b>44,342</b>	<b>50,749</b>	<b>54,824</b>
Cost of sales	-16,303	-20,923	-30,741	-35,229	-38,280
<b>Gross profit</b>	<b>4,305</b>	<b>7,774</b>	<b>13,602</b>	<b>15,520</b>	<b>16,544</b>
Other income	259	882	682	732	772
S&D expenses	-2,180	-2,379	-3,326	-3,806	-4,112
Administrative expenses	-10,487	-2,063	-2,882	-3,299	-3,564
R&D expenses	-277	-581	-887	-1,015	-1,096
<b>EBIT</b>	<b>-8,380</b>	<b>3,633</b>	<b>7,189</b>	<b>8,132</b>	<b>8,544</b>
Net finance income/(cost)	-1,443	-1,205	-1,359	-1,285	-1,182
Finance income	366	347	385	397	477
Finance expenses	-1,809	-1,552	-1,745	-1,682	-1,658
Other gains/(losses)	0	0	0	0	0
Profit of JV and associates	110	222	235	243	259
<b>Pretax profit</b>	<b>-9,713</b>	<b>2,650</b>	<b>6,065</b>	<b>7,090</b>	<b>7,621</b>
Income tax	1,425	-682	-1,559	-1,822	-1,959
<b>After tax profit</b>	<b>-8,288</b>	<b>1,968</b>	<b>4,506</b>	<b>5,268</b>	<b>5,662</b>
MI/discontinued operation	9,630	63	45	53	57
<b>Net profit</b>	<b>1,342</b>	<b>2,031</b>	<b>4,551</b>	<b>5,321</b>	<b>5,719</b>
<b>Recurring net profit</b>	<b>508</b>	<b>2,199</b>	<b>4,551</b>	<b>5,321</b>	<b>5,719</b>
D&A	924	837	852	879	911
<b>EBITDA</b>	<b>-7,456</b>	<b>4,470</b>	<b>8,041</b>	<b>9,012</b>	<b>9,454</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Pretax profit</b>	<b>1,252</b>	<b>2,650</b>	<b>6,065</b>	<b>7,090</b>	<b>7,621</b>
Finance cost	1,488	1,451	1,745	1,682	1,658
Interest income	-398	-347	-385	-397	-477
Profit or loss of associates	-90	-222	-235	-243	-259
Disposal of PP&E/business	-10,763	-152	0	0	0
Depreciation and amortization	968	837	852	879	911
Income tax paid	-227	-431	-1,559	-1,822	-1,959
Change in working capital	10,037	1,152	-218	68	873
Others	186	-221	0	0	0
<b>Cash flow from operation</b>	<b>2,453</b>	<b>4,717</b>	<b>6,264</b>	<b>7,257</b>	<b>8,369</b>
Net capex on PP&E	-73	-272	-700	-1,046	-946
Investment in JV/associates	-8	-4	0	0	0
Investment in subsidiaries	10,428	0	0	0	0
Investment in intangible assets	-156	-103	-100	-100	0
Dividend received	5	4	0	0	0
Interest received	398	347	385	397	477
Others	-6,558	-7,214	0	0	0
<b>Cash flow from investing</b>	<b>4,036</b>	<b>-7,242</b>	<b>-415</b>	<b>-749</b>	<b>-469</b>
Equity financing/(repurchase)	216	37	-2,145	1,074	0
Net bank borrowings	-3,442	6,817	-1,400	-1,000	100
Dividend paid	-1,141	-1,308	-1,952	-2,731	-3,193
Interest paid	-1,527	-1,428	-1,745	-1,682	-1,658
Others	-12	-16	0	0	0
<b>Cash flow from financing</b>	<b>-5,906</b>	<b>4,102</b>	<b>-7,242</b>	<b>-4,339</b>	<b>-4,751</b>
Change in cash	583	1,577	-1,392	2,169	3,149
Cash at beginning of the year	6,575	7,148	8,754	7,362	9,531
Exchange and others	-10	29	0	0	0
Cash at the end of the year	7,148	8,754	7,362	9,531	12,679

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>25,218</b>	<b>28,657</b>	<b>28,512</b>	<b>30,558</b>	<b>29,655</b>
PP&E	6,274	6,077	6,185	6,618	6,923
Lease prepayment	1,935	1,943	1,893	1,843	1,793
JV/associates	3,123	3,500	3,735	3,978	4,237
Finance lease receivables	1,870	3,656	2,175	3,108	1,398
Goodwill	2,088	2,046	2,046	2,046	2,046
Trade receivables	4,106	5,498	6,651	7,253	7,767
Intangible assets	2,250	2,153	2,043	1,927	1,708
Financial assets	2,154	2,379	2,379	2,379	2,379
Others	0	0	0	0	0
Deferred tax assets	1,358	1,276	1,276	1,276	1,276
Deposits	60	129	129	129	129
<b>Current assets</b>	<b>57,894</b>	<b>64,762</b>	<b>73,251</b>	<b>72,246</b>	<b>82,376</b>
Inventories	8,886	9,551	12,178	10,600	12,473
Trade & other receivables	22,661	21,554	25,826	27,009	28,265
Finance lease receivables	10,931	8,835	11,818	9,038	12,891
Financial assets at FVPL	6,323	13,787	13,787	13,787	13,787
Others	897	1,097	1,097	1,097	1,097
Pledged deposits	1,048	1,184	1,184	1,184	1,184
Cash	7,148	8,754	7,362	9,531	12,679
<b>Current liabilities</b>	<b>24,488</b>	<b>39,623</b>	<b>48,758</b>	<b>46,988</b>	<b>53,745</b>
Trade and other payables	14,992	15,786	24,640	22,654	28,736
Bank borrowings	9,348	22,044	21,844	21,644	21,744
Tax payable	148	151	151	151	151
Contract liabilities	0	1,602	2,083	2,499	3,074
Others	0	40	40	40	40
<b>Non-current liabilities</b>	<b>20,434</b>	<b>15,065</b>	<b>13,865</b>	<b>13,065</b>	<b>13,065</b>
Bank borrowings	19,296	13,645	12,445	11,645	11,645
Deferred tax liabilities	485	429	429	429	429
Others	653	991	991	991	991
<b>Equity</b>	<b>38,190</b>	<b>38,731</b>	<b>39,140</b>	<b>42,751</b>	<b>45,221</b>
Shareholders' equity	37,540	38,164	38,618	42,282	44,809
MI	650	567	522	469	413

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Concrete machinery	32%	35%	37%	37%	36%
Crane machinery	29%	43%	45%	45%	45%
Others machinery	16%	14%	14%	14%	15%
Agricultural machinery	10%	5%	3%	3%	3%
Financial services	2%	2%	1%	1%	1%
Environmental (discontinued)	11%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	20.9	27.1	30.7	30.6	30.2
EBIT margin	(40.7)	12.7	16.2	16.0	15.6
Net profit margin	(40.2)	6.9	10.2	10.4	10.3
<b>Growth (%)</b>					
Revenue	2.9	39.3	54.5	14.4	8.0
Gross profit	(9.9)	80.6	75.0	14.1	6.6
EBIT	n/a	n/a	97.9	13.1	5.1
Core net profit	54.4	332.9	107.0	16.9	7.5
<b>Balance sheet ratio</b>					
Current ratio (x)	2.4	1.6	1.5	1.5	1.5
Trade receivable turnover days	548	342	245	240	234
Finance lease receivable turnover days	238	161	109	94	88
Inventory turnover days	242	161	129	118	110
Payable turnover days	359	268	240	245	245
Net debt / total equity (%)	39.6	33.6	33.2	23.0	15.0
<b>Profitability (%)</b>					
ROA	1.6	2.3	4.7	5.2	5.3
Core ROE	1.4	5.8	11.9	13.2	13.1
<b>Per share data</b>					
EPS (RMB)	0.18	0.27	0.58	0.68	0.73
Core EPS (RMB)	0.07	0.29	0.58	0.68	0.73
BVPS (RMB)	4.82	4.89	4.92	5.39	5.71
DPS (RMB)	0.20	0.25	0.35	0.41	0.44

Source: Company data, CMBIS estimates

# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIS Ratings

**BUY** : Stock with potential return of over 15% over next 12 months  
**HOLD** : Stock with potential return of +15% to -10% over next 12 months  
**SELL** : Stock with potential loss of over 10% over next 12 months  
**NOT RATED** : Stock is not rated by CMBIS

**OUTPERFORM** : Industry expected to outperform the relevant broad market benchmark over next 12 months  
**MARKET-PERFORM** : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months  
**UNDERPERFORM** : Industry expected to underperform the relevant broad market benchmark over next 12 months

## CMB International Securities Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

**CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.