

## Jiangsu Hengli (601100 CH)

### Site visit confirms strong growth momentum

- ❖ **Key highlights:** We visited Jiangsu Hengli's headquarters and production base in Changzhou last week. Key positives: (1) Outstanding product quality enables Hengli to continue to gain market share from the Japanese players; (2) Hengli is well-prepared to boost the sales of hydraulic pumps and valves, an area that is currently dominated by the foreign players, which will serve as a key growth driver for the coming few years; (3) Hengli is currently running at full utilization rate (24 hours per day) due to very strong backlog (monthly production plan: 45k units). Hengli preannounced in Jan that its 2018E net profit is expected to grow 114-130% YoY to ~RMB820-880mn. We see potential 20% total revenue growth in 2019E, with potential margin expansion driven by pumps & valves.
- ❖ **Company background.** Jiangsu Hengli was founded in 2005, headquartered in Changzhou, Jiangsu. Hengli has expanded its product line to hydraulic components, precision castings, pneumatic components and hydraulic systems. Hengli currently has ~40% market share in hydraulic cylinder for excavator (Hengli's key products) in China. WANG's family is the controlling shareholder with ~71% interest in Hengli. The Company has been listed in SSE since 2011.
- ❖ **Hengli has already become an indispensable supplier for its customers.** Hengli spent more than a decade to establish its track record and has successfully become the key hydraulic cylinder supplier for the tier-one excavator manufactures, such as **SANY Heavy (600031 CH, NR)**, **Caterpillar (CAT US, NR)** and **XCMG (000425 CH, NR)**. For instance, Hengli has already supplied >50% of CAT's hydraulic cylinders. During the site visit, we noted that Hengli has well-designed production lines equipped with highly automatic robots and machines.
- ❖ **Market share gains to continue.** Normally, an excavator is equipped with four units of hydraulic cylinder and one set of pump & valve. Given that excavator sales in China was 203k units in 2018, this translated into ~812k units of hydraulic cylinder demand. Currently, Hengli has >40% of market share in hydraulic cylinder, and there exists further room to gain market share from peers such as **KYB (7242 JP, NR)**. Hengli's hydraulic cylinder products are priced even higher than its competitors due to its high performance and quality.
- ❖ **Hydraulic pump & valve the next growth driver.** Hengli is on track to ramp up its capacity on pumps and valves. Given that the ASP of pump & valve is several times higher than hydraulic cylinder, we see room for Hengli to boost its pump & valve revenue to a level similar to that of hydraulic cylinder in a few years' time. Hengli is currently pricing its pump & valves ~15% below its competitors in order to gain market share. Several existing customers have started the procurement of pump & valve from Hengli.

#### Earnings summary

| (YE 31 Dec)         | FY15A | FY16A | FY17A |
|---------------------|-------|-------|-------|
| Turnover (RMB mn)   | 1,088 | 1,370 | 2,795 |
| Net Income (RMB mn) | 64    | 70    | 382   |
| EPS (RMB)           | 0.07  | 0.08  | 0.43  |
| EPS CHG (%)         | -30.9 | 10.8  | 442.9 |
| EV/EBITDA (x)       | 256.5 | 163.4 | 40.2  |
| P/E (x)             | 414.1 | 373.9 | 68.9  |
| P/B (x)             | 7.6   | 7.5   | 6.8   |
| Yield (%)           | 0.1   | 0.2   | 0.5   |
| ROE (%)             | 1.8   | 2.0   | 10.4  |
| Net gearing (%)     | 1.6   | 3.3   | 5.0   |

Source: Company, CMBIS estimates

### NOT RATED

Current Price RMB29.82

#### Wayne Fung, CFA

Tel : (852) 3900 0826

Email : waynefung@cmbi.com.hk

#### China Capital Goods Sector

|                          |            |
|--------------------------|------------|
| Mkt. Cap. (RMB mn)       | 26,301     |
| Avg. 3mths t/o (RMB mn)  | 98         |
| 52W High/Low (RMB)       | 30.12/17.2 |
| Total Issued Shares (mn) | 882        |

Source: HKEX, Bloomberg

#### Shareholding Structure

|                  |       |
|------------------|-------|
| WANG's family    | 71.0% |
| Deutsche Bank AG | 4.1%  |
| Free float       | 25.0% |

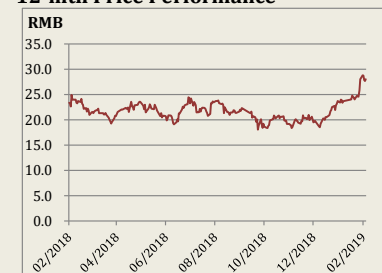
Source: Shanghai Stock Exchange

#### Share Performance

|       | Absolute | Relative |
|-------|----------|----------|
| 1-mth | +18%     | +4%      |
| 3-mth | +41%     | +25%     |
| 6-mth | +20%     | +10%     |

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

Auditor: RSM

Web-site: [www.henglihydraulic.com](http://www.henglihydraulic.com)

- ❖ **Specialized cylinder for heavy equipment growth driven by recovery of infrastructure spending.** This product is mainly for tunnel boring machine. Hengli sees good growth momentum in 2019E, driven by the recovery of urban rail transit investment. We see potential segment revenue growth of 20% in 2019E.
- ❖ **Risk factors:** (1) weakness in demand for excavators; (2) increase in component cost.

**Figure 1: Hengli's hydraulic cylinder for 20T excavator**

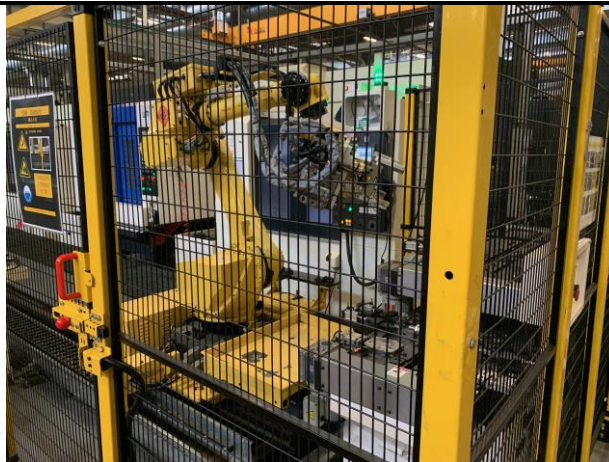

Source: CMBIS

**Figure 2: Hengli's piston pumps (InLine brand)**


Source: CMBIS

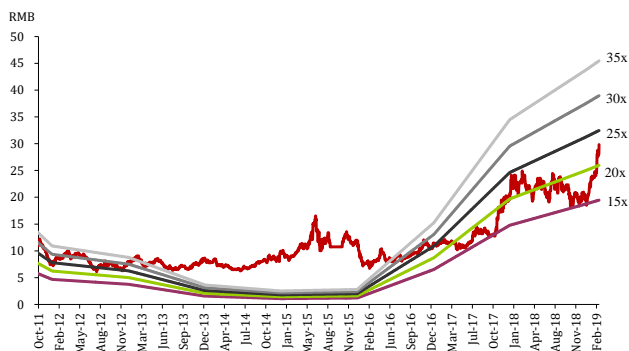
**Figure 3: Hengli's control valve products**


Source: CMBIS

**Figure 4: Hengli's robotic equipment and CNC centre**


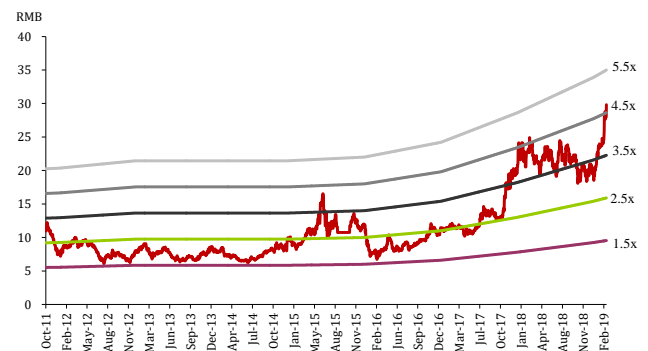
Source: CMBIS

Figure 5: Hengli's P/E band



Source: Bloomberg, CMBIS estimates

Figure 6: Hengli's P/B band



Source: Bloomberg, CMBIS estimates

Figure 7: Segment revenue and gross profit

| (RMB mn)   | 2010         | 2011         | 2012         | 2013         | 2014          | 2015         | 2016         | 2017          |
|--|--------------|--------------|--------------|--------------|---------------|--------------|--------------|---------------|
| <b>Revenue</b>                                     |              |              |              |              |               |              |              |               |
| Hydraulic cylinder for excavator                   | 608          | 887          | 728          | 750          | 559           | 407          | 529          | 1,154         |
| Specialised hydraulic cylinder for heavy equipment | 195          | 236          | 285          | 327          | 415           | 516          | 560          | 1,042         |
| Hydraulic pump and valve                           | 0            | 0            | 0            | 0            | 4             | 3            | 83           | 249           |
| Completed set of equipment                         | 0            | 0            | 18           | 137          | 80            | 81           | 90           | 171           |
| Component  | 14           | 9            | 12           | 11           | 26            | 67           | 95           | 165           |
| <b>Revenue (hydraulic business)</b>                | <b>817</b>   | <b>1,133</b> | <b>1,043</b> | <b>1,226</b> | <b>1,084</b>  | <b>1,074</b> | <b>1,358</b> | <b>2,781</b>  |
| Other business                                     | 0            | 1            | 2            | 4            | 9             | 14           | 12           | 14            |
| <b>Total revenue</b>                               | <b>817</b>   | <b>1,133</b> | <b>1,045</b> | <b>1,230</b> | <b>1,093</b>  | <b>1,088</b> | <b>1,370</b> | <b>2,795</b>  |
| <b>Revenue growth</b>                              |              |              |              |              |               |              |              |               |
| Hydraulic cylinder for excavator                   | 205.8%       | 45.9%        | -17.9%       | 3.0%         | -25.5%        | -27.2%       | 30.0%        | 118.1%        |
| Specialised hydraulic cylinder for heavy equipment | -3.9%        | 21.5%        | 20.5%        | 14.7%        | 27.0%         | 24.2%        | 8.6%         | 86.1%         |
| Hydraulic pump and valve                           | -            | -            | -            | -            | -             | -20.8%       | 2634.7%      | 198.6%        |
| Completed set of equipment                         | -            | -            | -            | 658.0%       | -41.8%        | 1.1%         | 12.0%        | 89.5%         |
| Component  | -4.1%        | -34.4%       | 28.1%        | -2.9%        | 129.0%        | 158.5%       | 40.7%        | 73.8%         |
| <b>Revenue (hydraulic business)</b>                | <b>96.3%</b> | <b>38.7%</b> | <b>-7.9%</b> | <b>17.5%</b> | <b>-11.6%</b> | <b>-0.9%</b> | <b>26.4%</b> | <b>104.8%</b> |
| Other business                                     | 258.7%       | 95.0%        | 177.5%       | 80.5%        | 125.7%        | 46.2%        | -10.5%       | 14.6%         |
| <b>Total revenue</b>                               | <b>96.4%</b> | <b>38.7%</b> | <b>-7.8%</b> | <b>17.7%</b> | <b>-11.1%</b> | <b>-0.5%</b> | <b>26.0%</b> | <b>104.0%</b> |
| <b>Gross profit</b>                                |              |              |              |              |               |              |              |               |
| Hydraulic cylinder for excavator                   | 261          | 388          | 296          | 276          | 157           | 102          | 134          | 448           |
| Specialised hydraulic cylinder for heavy equipment | 80           | 101          | 98           | 91           | 82            | 96           | 108          | 331           |
| Hydraulic pump and valve                           | 0            | 0            | 0            | 0            | 1             | (6)          | 13           | 46            |
| Completed set of equipment                         | 0            | 0            | 6            | 49           | 18            | 14           | 16           | 29            |
| Component  | 4            | 2            | 3            | 4            | 6             | 14           | 24           | 58            |
| <b>Gross profit (hydraulic business)</b>           | <b>345</b>   | <b>491</b>   | <b>404</b>   | <b>419</b>   | <b>264</b>    | <b>221</b>   | <b>295</b>   | <b>912</b>    |
| Other business                                     | 0            | 1            | 2            | 2            | 5             | 10           | 7            | 5             |
| <b>Total gross profit</b>                          | <b>345</b>   | <b>492</b>   | <b>406</b>   | <b>421</b>   | <b>269</b>    | <b>231</b>   | <b>302</b>   | <b>917</b>    |
| <b>Gross margin</b>                                |              |              |              |              |               |              |              |               |
| Hydraulic cylinder for excavator                   | 42.9%        | 43.8%        | 40.6%        | 36.7%        | 28.2%         | 25.2%        | 25.3%        | 38.8%         |
| Specialised hydraulic cylinder for heavy equipment | 41.2%        | 42.5%        | 34.4%        | 27.7%        | 19.8%         | 18.6%        | 19.2%        | 31.7%         |
| Hydraulic pump and valve                           | -            | -            | -            | -            | 17.8%         | -182.8%      | 15.1%        | 18.6%         |
| Completed set of equipment                         | -            | -            | 35.7%        | 35.5%        | 22.7%         | 16.7%        | 18.1%        | 16.8%         |
| Component  | 26.6%        | 27.0%        | 29.2%        | 34.4%        | 22.5%         | 21.1%        | 25.4%        | 35.5%         |
| <b>Gross margin (hydraulic business)</b>           | <b>42.2%</b> | <b>43.4%</b> | <b>38.7%</b> | <b>34.2%</b> | <b>24.4%</b>  | <b>20.5%</b> | <b>21.7%</b> | <b>32.8%</b>  |
| Other business                                     | 99.8%        | 99.9%        | 95.8%        | 45.2%        | 51.5%         | 74.4%        | 55.2%        | 38.5%         |
| <b>Average gross margin</b>                        | <b>42.3%</b> | <b>43.4%</b> | <b>38.8%</b> | <b>34.2%</b> | <b>24.6%</b>  | <b>21.2%</b> | <b>22.0%</b> | <b>32.8%</b>  |

Source: Company, CMBIS

**Figure 8: Income statement**

| YE Dec 31(RMB mn)                    | 2014         | 2015         | 2016         | 2017         | 1H17         | 1H18         | Change (YoY)  |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| <b>Total revenue</b>                 | <b>1,093</b> | <b>1,088</b> | <b>1,370</b> | <b>2,795</b> | <b>1,359</b> | <b>2,164</b> | <b>59.2%</b>  |
| Cost of sales                        | (824)        | (857)        | (1,068)      | (1,878)      | (977)        | (1,415)      | 44.8%         |
| <b>Gross profit</b>                  | <b>269</b>   | <b>231</b>   | <b>302</b>   | <b>917</b>   | <b>382</b>   | <b>749</b>   | <b>96.1%</b>  |
| Surcharge                            | (7)          | (9)          | (19)         | (36)         | (15)         | (23)         | 54.9%         |
| S&D expenses                         | (54)         | (59)         | (69)         | (96)         | (43)         | (48)         | 13.4%         |
| Administrative expenses              | (172)        | (195)        | (200)        | (287)        | (121)        | (160)        | 31.8%         |
| Asset impairment                     | (3)          | (17)         | (26)         | (38)         | (11)         | (11)         | 0.6%          |
| <b>EBIT</b>                          | <b>33</b>    | <b>(49)</b>  | <b>(13)</b>  | <b>460</b>   | <b>192</b>   | <b>506</b>   | <b>163.6%</b> |
| Net finance income/(cost)            | 8            | 32           | 30           | (85)         | (30)         | (4)          | -86.0%        |
| Finance income                       | 21           | 54           | 69           | 23           | 9            | 26           | 175.1%        |
| Finance expenses                     | (14)         | (22)         | (39)         | (108)        | (40)         | (30)         | -24.0%        |
| Other gains/(losses)                 | 68           | 91           | 75           | 71           | 34           | 37           | 9.4%          |
| Share of profit of JV and associates | 0            | 0            | 0            | 0            | 0            | 0            | n/a           |
| <b>Pretax profit</b>                 | <b>108</b>   | <b>75</b>    | <b>92</b>    | <b>447</b>   | <b>195</b>   | <b>539</b>   | <b>175.6%</b> |
| Income tax                           | (19)         | (14)         | (25)         | (66)         | (34)         | (74)         | 121.2%        |
| <b>After tax profit</b>              | <b>89</b>    | <b>61</b>    | <b>67</b>    | <b>381</b>   | <b>162</b>   | <b>465</b>   | <b>186.9%</b> |
| MI                                   | 3            | 3            | 3            | 1            | (0)          | (1)          | 400.7%        |
| <b>Net profit</b>                    | <b>92</b>    | <b>64</b>    | <b>70</b>    | <b>382</b>   | <b>162</b>   | <b>463</b>   | <b>186.6%</b> |
| D&A                                  | 128          | 152          | 175          | 200          | 107          | 110          | 3.5%          |
| <b>EBITDA</b>                        | <b>161</b>   | <b>103</b>   | <b>162</b>   | <b>660</b>   | <b>299</b>   | <b>617</b>   | <b>106.5%</b> |

Source: Company, CMBIS

## 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

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

### *CMB International Securities Limited*

**Address:** 45/F, Champion Tower, 3 Garden Road, Central, 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 and/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.

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.