

Jiangsu Hengli Hydraulic (601100 CH)

Expect a strong 3Q; Robust demand in Oct; Raised estimate & TP

Reiterate BUY. We expect Hengli's share price momentum to continue driven by several near-term catalysts: (1) We forecast Hengli to report an impressive net profit growth of 95% YoY in 3Q20E; (2) Hengli's production plan in Oct suggests robust demand to continue across major products; (3) improvement in construction activities will continue to offer strong support to the demand for excavators and other machinery going forward. We revised up our earnings forecast in 2020E-22E by 3-6% (9-10% above consensus). Our TP is lifted to RMB87 from RMB82, based on unchanged multiple of 45x 2021E P/E (historical average).

■ **3Q20E results preview.** We estimate that Hengli's hydraulic cylinder volume reached 170k units (for excavators) and 34k units (for non-standardized products) in 3Q20E. Fast growing products such as valves and motors saw sequential monthly sales increase in 3Q. We forecast Hengli to deliver revenue growth of 50% YoY with gross margin expansion YoY, thanks to higher utilization rate. We estimate net profit to grow 95% YoY to RMB481mn in 3Q. Hengli is scheduled to report the results on 27 Oct.

■ **Production volume to stay high in Oct.** Based on our understanding, excavator cylinder monthly production volume reached 63k units in Sep, suggesting sequential growth. According to the production plan in Oct, excavator cylinder volume is expected to stay at similar level. Besides, the production plan for pump and valves implies sequential growth in Oct. We expect robust demand throughout 4Q, on the back of strong construction activities.

■ **Key risks:** (1) Slowdown of construction activities; (2) risk of overseas expansion; (3) increase in raw materials cost.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	4,211	5,414	7,021	8,439	9,420
YoY growth (%)	50.6	28.6	29.7	20.2	11.6
Net income (RMB mn)	837	1,296	2,027	2,524	2,897
EPS (RMB)	0.64	0.99	1.55	1.93	2.22
YoY growth (%)	119.1	54.9	56.4	24.5	14.8
Consensus EPS (RMB)	NA	NA	1.43	1.76	2.03
EV/EBITDA (x)	86.2	57.7	38.8	32.0	28.6
P/E (x)	116.7	75.3	48.2	38.7	33.7
P/B (x)	21.5	17.5	13.8	11.1	9.1
Yield (%)	0.3	0.5	0.8	1.0	1.2
ROE (%)	19.9	25.6	32.0	31.8	29.7
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price: RMB87.00
(Previous TP) RMB82.00
Up/Downside: +16%
Current Price: RMB74.77

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Stock Data

Mkt Cap (RMB mn)	97,602
Avg 3 mths t/o (RMB mn)	409
52w High/Low (RMB)	74.77/23.89
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

WANG's family	71.0%
CCASS (Hong Kong)	10.0%
Free float	19.0%

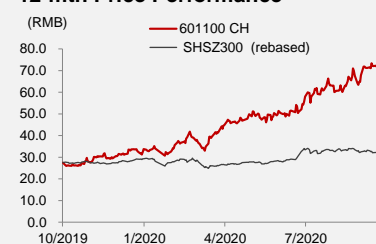
Source: Company data

Share Performance

	Absolute	Relative
1-mth	15.4%	12.9%
3-mth	28.9%	30.9%
6-mth	66.5%	34.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: RSM

- Jiangsu Hengli Hydraulic (601100 CH, BUY) – 2Q Net profit +85% YoY; significant margin expansion – 25 Aug 2020
- China Construction Machinery Sector – Sustainable demand for excavator in 2H20E – 12 Aug 2020
- China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020

Figure 1: 3Q results preview

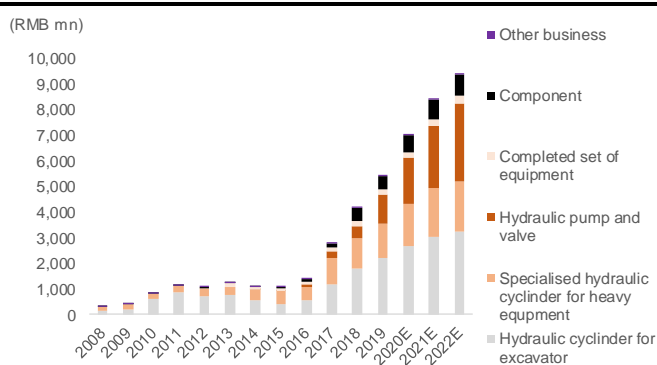
(RMB mn)	1Q19	1Q20	Change YoY	2Q19	2Q20	Change YoY	3Q19	3Q20E	Change YoY
Total revenue	1,569	1,369	-12.7%	1,224	2,087	70.5%	1,041	1,557	49.5%
Cost of sales	-1,023	-850	-16.9%	-736	-1,159	57.6%	-674	-903	34.0%
Gross profit	546	518	-5.0%	488	928	90.0%	367	654	78.1%
EBIT	395	363	-8.3%	344	744	116.5%	218	487	123.3%
Pretax profit	373	418	12.1%	405	759	87.2%	294	574	95.4%
Income tax	-47	-70	51.1%	-60	-118	97.2%	-47	-92	95.3%
After tax profit	327	348	6.5%	345	641	85.5%	247	482	95.4%
MI	-0	-1	32.8%	-1	-2	156.4%	-0	-1	306.4%
Net profit	326	347	6.5%	345	639	85.4%	246	481	95.1%
Key ratios			<i>ppt</i>			<i>ppt</i>			<i>ppt</i>
Gross margin	34.8%	37.9%	3.1	39.9%	44.5%	4.6	35.3%	42.0%	6.7
S&D expense ratio	1.2%	1.9%	0.7	2.4%	1.4%	-1.0	3.0%	1.4%	-1.6
Administrative and R&D exp ratio	6.1%	7.1%	1.1	9.2%	5.2%	-4.1	10.0%	8.0%	-2.0
Effective tax rate	12.5%	16.8%	4.3	14.8%	15.6%	0.8	16.0%	16.0%	-0.0

Source: Company data, CMBIS estimates

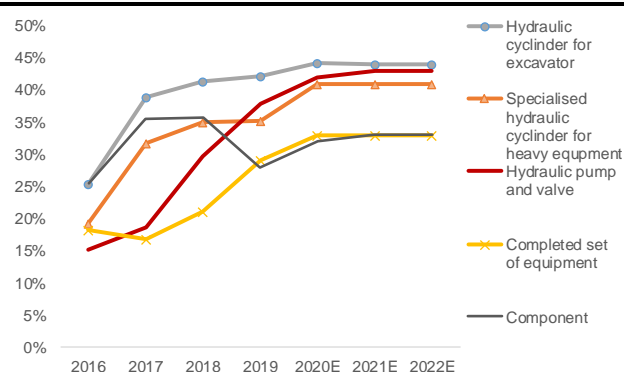
Figure 2: Change in key assumptions

(RMB mn)	Old			New			Change		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Revenue									
Hydraulic cylinder for excavator	2,623	2,951	3,128	2,684	3,047	3,229	2.3%	3.2%	3.2%
Specialised hydraulic cylinder for heavy equipment	1,650	1,760	1,848	1,650	1,876	1,947	0.0%	6.6%	5.4%
Hydraulic pump and valve	1,800	2,430	3,038	1,800	2,466	3,083	0.0%	1.5%	1.5%
Completed set of equipment	217	250	280	217	250	280	0.0%	0.0%	0.0%
Component	651	749	824	651	782	860	0.0%	4.3%	4.3%
Revenue (hydraulic business)	6,942	8,140	9,117	7,003	8,421	9,399	0.9%	3.4%	3.1%
Other business	22	24	27	18	19	21	-20.0%	-23.6%	-23.6%
Total revenue	6,964	8,164	9,144	7,021	8,439	9,420	0.8%	3.4%	3.0%
Gross margin									
Hydraulic cylinder for excavator	44.0%	44.0%	44.0%	44.3%	44.0%	44.0%	0.3	0.0	0.0
Specialised hydraulic cylinder for heavy equipment	40.0%	40.0%	40.0%	41.0%	41.0%	41.0%	1.0	1.0	1.0
Hydraulic pump and valve	41.0%	42.0%	42.0%	42.0%	43.0%	43.0%	1.0	1.0	1.0
Completed set of equipment	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	0.0	0.0	0.0
Component	30.0%	30.0%	30.0%	32.0%	33.0%	33.0%	2.0	3.0	3.0
Gross margin (hydraulic business)	40.6%	40.9%	40.9%	41.4%	41.7%	41.7%	0.8	0.8	0.8
Other business	66.0%	66.0%	66.0%	66.0%	66.0%	66.0%	0.0	0.0	0.0
Average gross margin	40.7%	41.0%	41.0%	41.5%	41.7%	41.8%	0.8	0.8	0.8
Net profit	1,963	2,380	2,743	2,027	2,524	2,897	3.2%	6.1%	5.6%

Source: Company data, CMBIS estimates

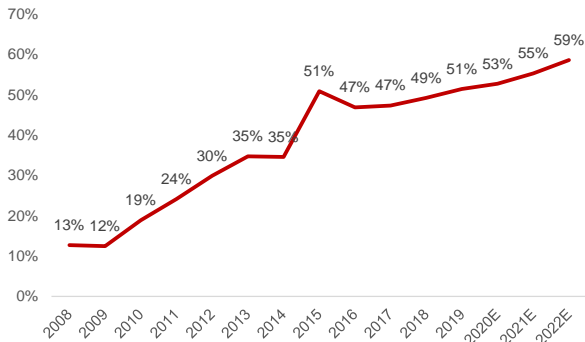
Figure 3: Hengli's revenue breakdown

Source: Company data, CMBIS estimates

Figure 4: Gross margin for segment

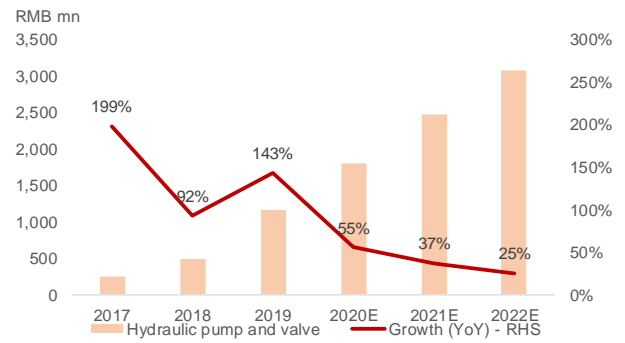
Source: Company data, CMBIS estimates

Figure 5: Hengli's market share in hydraulic cylinder for excavator



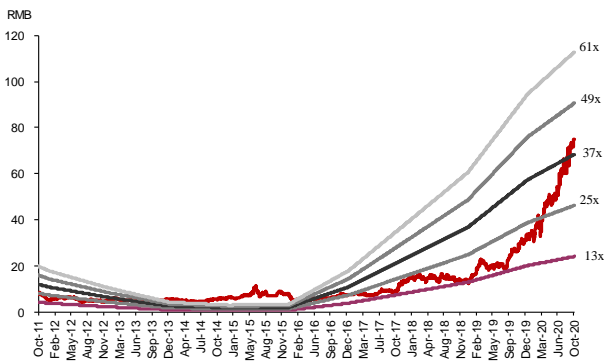
Source: Company data, CCMA, CMBIS estimates

Figure 6: Hengli's revenue of pump & valves



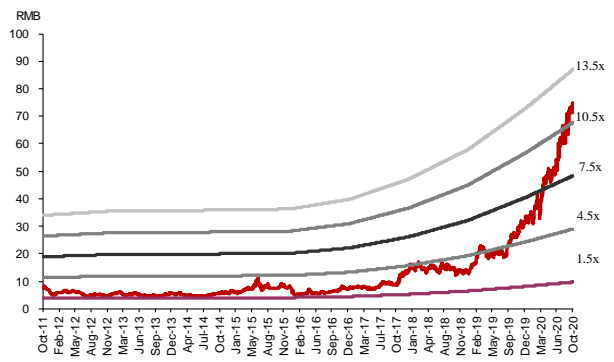
Source: Company reports, CMBIS

Figure 7: Hengli's P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 8: Hengli's P/B band



Source: Bloomberg, Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	4,211	5,414	7,021	8,439	9,420	Pretax profit	963	1,493	2,418	3,011	3,456
Cost of sales	-2,671	-3,369	-4,107	-4,916	-5,485	Finance cost	-32	-33	52	44	41
Gross profit	1,540	2,045	2,913	3,523	3,935	Profit or loss of associates	0	0	0	0	0
Surcharge	-43	-52	-70	-84	-94	Loss/(gain) on disposal PP&E/business	3	1	0	0	0
S&D expenses	-115	-111	-140	-160	-179	Depreciation & amortization	232	264	293	317	341
Administrative expenses	-385	-435	-527	-599	-659	Income tax paid	-337	-375	-387	-482	-553
Asset impairment	-119	-52	0	0	0	Change in working capital	-345	66	-595	-360	-300
EBIT	879	1,395	2,176	2,679	3,002	Others	332	253	0	0	0
Net finance income/(cost)	30	31	157	231	341	Cash flow from operation	799	1,660	1,780	2,531	2,984
Finance income	168	187	209	275	381	Net capex on PP&E	-361	-434	-500	-400	-400
Finance expenses	-138	-156	-52	-44	-41	Investment in JV/associates	0	0	0	0	0
Other gains/(losses)	54	67	84	101	113	Investment in subsidiaries	-117	0	0	0	0
Profit of JV and associates	0	0	0	0	0	Investment in intangibles	-19	-4	-10	-10	0
Pretax profit	963	1,493	2,418	3,011	3,456	Dividend received JV/associates	0	0	0	0	0
Income tax	-126	-195	-387	-482	-553	Others	216	-14	0	0	0
After tax profit	837	1,298	2,031	2,529	2,903	Cash flow from investing	-281	-452	-510	-410	-400
MI	-0	-2	-4	-5	-6	Proceeds from equity financing/(repurchase)	0	0	0	0	0
Net profit	837	1,296	2,027	2,524	2,897	Net bank borrowings	-8	-100	-150	-150	0
						Dividend paid	-139	-265	-529	-811	-1,010
D&A	232	264	293	317	341	Interest paid	-3	-107	-52	-44	-41
EBITDA	1,110	1,659	2,469	2,996	3,343	Others	-1	18	0	0	0
						Cash flow from financing	-152	-454	-731	-1,005	-1,050
						Change in cash	366	754	539	1,116	1,534
						Cash at beginning of the year	1,146	1,571	2,343	2,882	3,998
						Exchange and others	59	18	-0	-0	-0
						Cash at the end of the year	1,571	2,343	2,882	3,998	5,532

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	2,828	2,935	3,153	3,246	3,305	Sales mix (%)					
PP&E	2,233	2,364	2,583	2,678	2,748	Cylinder for excavator	43%	40%	38%	36%	34%
JV/associates	0	0	0	0	0	Cylinder for heavy equipment	27%	25%	24%	22%	21%
Goodwill	0	0	0	0	0	Hydraulic pump and valve	11%	21%	26%	29%	33%
Intangible assets	279	273	272	270	258	Completed set of equipment	5%	3%	3%	3%	3%
AFS investments	10	0	0	0	0	Component	13%	9%	9%	9%	9%
Others	257	257	257	257	257	Other business	1%	0%	0%	0%	0%
Deferred tax assets	49	41	41	41	41	Total revenue	100%	100%	100%	100%	100%
Current assets	4,443	5,492	6,889	8,465	10,454	Profit & loss ratio (%)					
Inventories	1,050	997	1,478	1,485	1,821	Gross margin	36.6	37.8	41.5	41.7	41.8
Trade and bill receivables	1,328	1,639	2,016	2,470	2,589	EBIT margin	20.9	25.8	31.0	31.7	31.9
Prepayment	135	98	98	98	98	Net profit margin	19.9	24.0	28.9	30.0	30.8
Others	358	414	414	414	414	Growth (%)					
Pledged deposits	0	0	0	0	0	Revenue	50.6	28.6	29.7	20.2	11.6
Cash	1,571	2,343	2,882	3,998	5,532	Gross profit	67.9	32.7	42.5	20.9	11.7
Current liabilities	1,981	2,170	2,333	2,334	2,488	EBIT	90.9	58.7	56.0	23.1	12.1
Trade and bill payables	691	791	1,054	1,155	1,310	Net profit	119.1	54.9	56.4	24.5	14.8
Bank borrowings	905	937	837	737	737	Balance sheet ratio					
Tax payable	24	62	62	62	62	Current ratio (x)	2.2	2.5	3.0	3.6	4.2
Advance from customers	154	192	192	192	192	Receivable turnover days	100	100	95	97	98
Others	208	188	188	188	188	Inventory turnover days	128	111	110	110	110
Non-current liabilities	715	643	593	543	543	Payable turnover days	82	80	82	82	82
Bank borrowings	353	200	150	100	100	Net debt / total equity (%)	Net	Net	Net	Net	Net
Deferred tax liabilities	47	70	70	70	70	Profitability (%)					
Deferred income	165	223	223	223	223	ROA	12.5	16.5	21.9	23.2	22.7
Others	150	150	150	150	150	ROE	19.9	25.6	32.0	31.8	29.7
Equity	4,575	5,614	7,116	8,834	10,727	Per share data					
Shareholders' equity	4,547	5,584	7,081	8,795	10,682	EPS (RMB)	0.64	0.99	1.55	1.93	2.22
MI	28	30	34	40	45	BVPS (RMB)	3.48	4.28	5.42	6.74	8.18
						DPS (RMB)	0.20	0.41	0.62	0.77	0.89

Source: Company data, CMBIS estimates

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