11 Dec 2020

CMB International Securities | Equity Research | Company Update

Jiangsu Hengli Hydraulic (601100 CH)

Solid share gain story for both short and long-term; Raise earnings est. & TP

BUY (Maintain)

We see potential earnings upside in 2020E-22E driven by several drivers: (1) Short term: Hengli's production plan in Dec implies 20% MoM increase in hydraulic cylinders output volume, which is surprisingly strong; (2) Medium term: Solid market share gain on the back of the rising market share of Chinese-brand excavator manufactures (Hengli's customers); (3) Long-term: Trend of import substitution of pump & valves and other products is clear. We revise up our earnings forecast in 2020E-22E by 8-10% (9-10% above consensus), after revising up both sales volume and gross margin assumptions. We continue to like Hengli's solid position in the high-end hydraulic components industry with clear roadmap to achieve import substitution. Our TP is lifted to RMB114.4 from RMB87, based on 55x 2021E P/E (30% premium to the historical average of 42x).

- **Resilient demand for excavator in 2021E.** For the industry as a whole, major manufacturers of excavator delivered sales volume of 296k units in 11M20, up 37% YoY, according to CCMA. We expect the full year sales volume growth will reach ~40%. In 2021E, we see upside to our existing excavator demand growth forecast of 3%, driven by infrastructure spending growth and the continuous trend of the substitution of labour by excavators.
- **Hengli's growth is driven by structural factors**. We estimate a single-digit growth of excavator demand will be enough for Hengli to deliver 20% revenue growth in 2021E, given that the Chinese excavator makers (majority of them are Hengli's customers with high installation ratios), such as **SANY Heavy (600031 CH, BUY)**, are gaining market share, which will drive Hengli's share gain. We forecast Hengli's market share in hydraulic cylinder to increase from 52% in 2020E to 61% in 2022E. Besides, we expect pump & valve for large-size excavators, as well as non-standardized hydraulic components for various industries will serve as other key drivers.
- **Latest production plan suggests robust demand in 1Q21E**. According to Hengli's production plan in Dec, the scheduled production volume of hydraulic cylinder (for excavator) is expected to reach 79k units, up 20% MoM. We estimate this will translate into ~40k units for excavator demand for the industry in Jan 2021E, which is impressive given that the industry sales volume was only 9.9k units in Jan 2020. On the other hand, we expect Hengli's hydraulic pump and valves will see strong growth in Dec on MoM basis.
- **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	7,242	8,745	9,886
YoY growth (%)	50.6	28.6	33.8	20.7	13.0
Net income (RMB mn)	837	1,296	2,186	2,750	3,204
EPS (RMB)	0.64	0.99	1.67	2.11	2.45
YoY growth (%)	119.1	54.9	68.6	25.8	16.5
Consensus EPS (RMB)	NA	NA	1.53	1.91	2.25
EV/EBITDA (x)	114.0	76.3	48.2	39.4	34.8
P/E (x)	153.6	99.1	58.8	46.7	40.1
P/B (x)	28.3	23.0	17.7	14.1	11.5
Yield (%)	0.2	0.4	0.7	0.9	1.0
ROE (%)	19.9	25.6	34.1	33.6	31.5
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

Target Price:	**RMB114.40**
(Previous TP	RMB87.00)
Up/Downside:	**+16%**
Current Price:	**RMB98.43**

China Capital Goods

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Stock Data

Mkt Cap (RMB mn)	128,487
Avg 3 mths t/o (RMB mn)	467
52w High/Low (RMB)	100.5/29.24
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

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

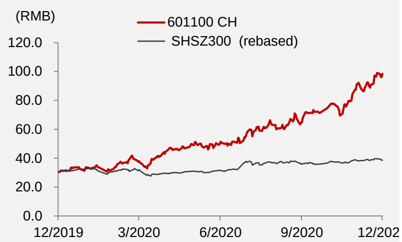
Source: Company data

Share Performance

	Absolute	Relative
1-mth	9.6%	10.5%
3-mth	48.1%	37.4%
6-mth	93.2%	58.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: RSM

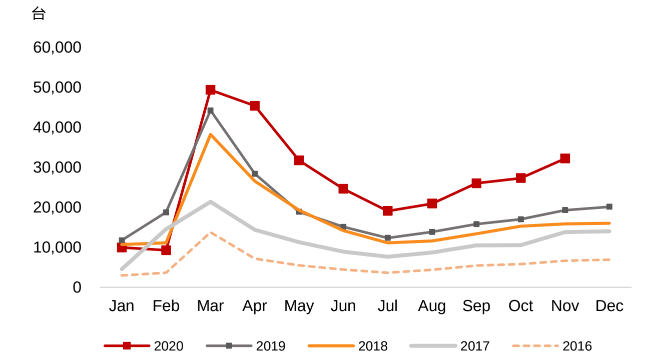
1. Jiangsu Hengli Hydraulic (601100 CH, BUY) – Expect a strong 3Q; Robust demand in Oct;; Raised estimate & TP – 12 Oct 2020
2. Jiangsu Hengli Hydraulic (601100 CH, BUY) – 2Q Net profit +85% YoY; significant margin expansion – 25 Aug 2020
3. China Construction Machinery Sector – Sustainable demand for excavator in 2H20E – 12 Aug 2020

Figure 1: Change in key assumptions

(RMB mn)	Old 2020E	Old 2021E	Old 2022E	New 2020E	New 2021E	New 2022E	Change 2020E	Change 2021E	Change 2022E
Revenue									
Hydraulic cyclinder for excavator	2,684	3,047	3,229	2,906	3,299	3,497	*8.3%*	*8.3%*	*8.3%*
Specialised hydraulic cyclinder for heavy equpment	1,650	1,876	1,947	1,650	1,876	2,040	*0.0%*	*0.0%*	*4.8%*
Hydraulic pump and valve	1,800	2,466	3,083	1,800	2,520	3,150	*0.0%*	*2.2%*	*2.2%*
Completed set of equipment	217	250	280	217	250	280	*0.0%*	*0.0%*	*0.0%*
Component	651	782	860	651	782	899	*0.0%*	*0.0%*	*4.5%*
Revenue (hydraulic business)	**7,003**	**8,421**	9,399	**7,225**	**8,727**	**9,866**	***3.2%***	***3.6%***	***5.0%***
Other business	18	19	21	18	19	21	*0.0%*	*0.0%*	*0.0%*
Total revenue	**7,021**	**8,439**	9,420	**7,242**	**8,745**	**9,886**	***3.2%***	***3.6%***	***5.0%***
Gross margin									
Hydraulic cylinder for excavator	*44.3%*	*44.0%*	*44.0%*	*44.7%*	*44.7%*	*44.5%*	*0.4*	*0.7*	*0.5*
Specialised hydraulic cyclinder for heavy equpment	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*41.0%*	*0.0*	*0.0*	*0.0*
Hydraulic pump and valve	*42.0%*	*43.0%*	*43.0%*	*43.0%*	*44.0%*	*44.0%*	*1.0*	*1.0*	*1.0*
Completed set of equipment	*33.0%*	*33.0%*	*33.0%*	*33.0%*	*34.0%*	*34.0%*	*0.0*	*1.0*	*1.0*
Component	*32.0%*	*33.0%*	*33.0%*	*32.0%*	*33.0%*	*33.0%*	*0.0*	*0.0*	*0.0*
Gross margin (hydraulic business)	***41.4%***	***41.7%***	***41.7%***	***41.9%***	***42.3%***	***42.3%***	*0.5*	*0.7*	*0.6*
Other business	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*0.0*	*0.0*	*0.0*
Average gross margin	***41.5%***	***41.7%***	***41.8%***	***42.0%***	***42.4%***	***42.3%***	*0.5*	*0.7*	*0.6*
Net profit	**2,027**	**2,524**	**2,897**	**2,186**	**2,750**	**3,204**	***7.9%***	***9.0%***	***10.6%***

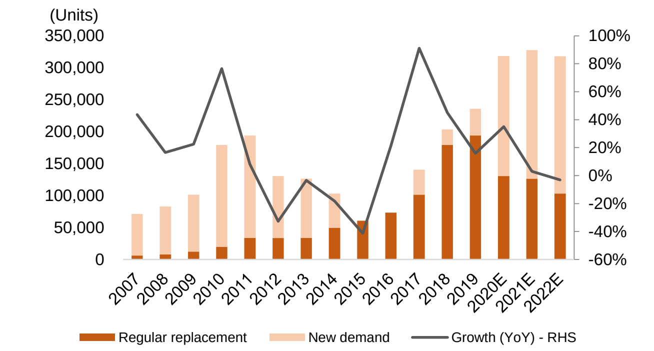
Source: Company data, CMBIS estimates

Figure 2: Excavator monthly sales volume (industry)



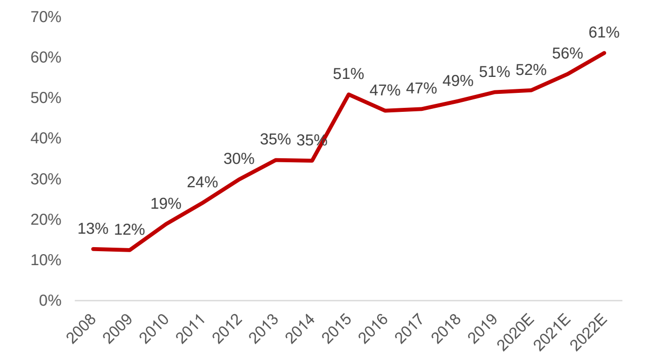
Source: CCMA, CMBIS

Figure 3: CMBIS excavator sales projection (industry)



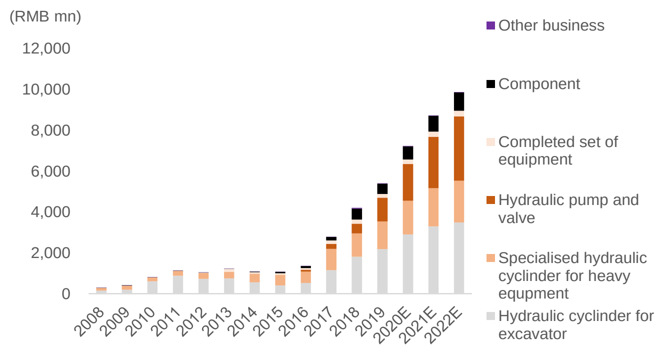
Source: Company data, CMBIS estimates

Figure 4: Hengli's market share in hydraulic cylinder for excavator



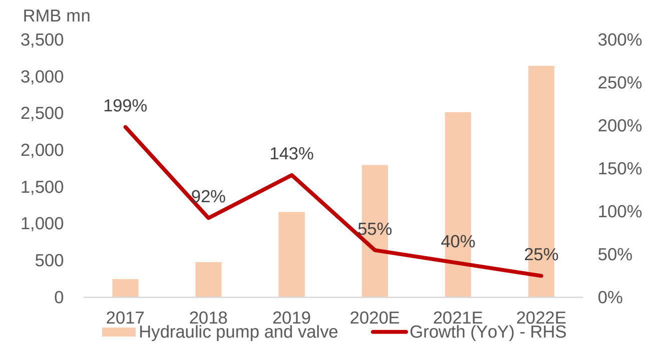
Source: Company data, CMBIS estimates

Figure 5: Hengli's revenue breakdown



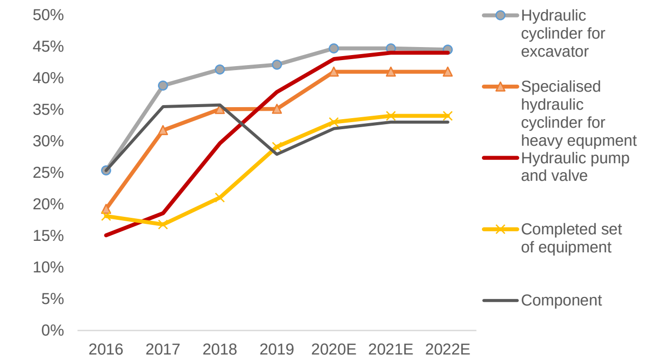
Source: Company data, CMBIS estimates

Figure 6: Hengli's revenue of pump & valves



Source: Company data, CMBIS estimates

Figure 7: Gross margin by segment

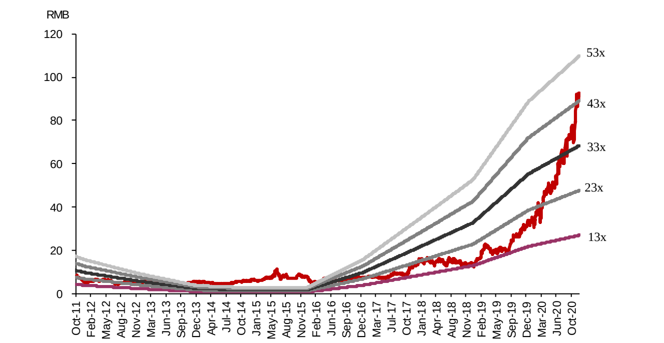


Source: Company data, CMBIS estimates

Valuation

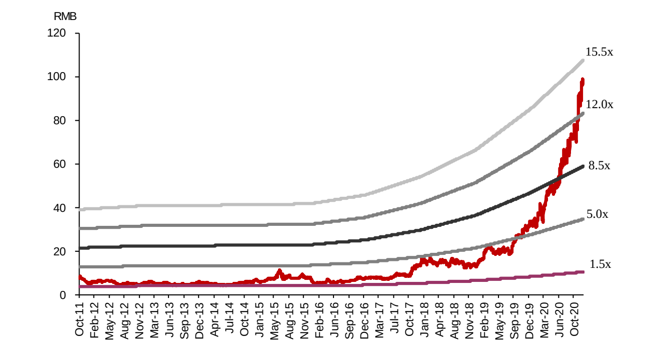
We raise our TP to RMB114.4 from RMB87, based on 55x 2021E P/E (30% premium to the historical average of 42x). We believe the valuation premium is justified due to improving earnings visibility for a couple of reasons: (1) the policy of domestic circulation and competitive landscape are favourable for Hengli to achieve further import substitution across different products; and (2) Hengli's growth has become more structural rather than cyclical.

Figure 8: Hengli's P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 9: Hengli's P/B band



Source: Bloomberg, Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	**4,211**	**5,414**	**7,242**	**8,745**	**9,886**
Cost of sales	-2,671	-3,369	-4,201	-5,037	-5,702
Gross profit	**1,540**	**2,045**	**3,041**	**3,708**	**4,184**
Surcharge	-43	-52	-72	-87	-99
S&D expenses	-115	-111	-145	-166	-188
Administrative expenses	-385	-435	-492	-560	-603
Asset impairment	-119	-52	0	0	0
EBIT	**879**	**1,395**	**2,332**	**2,895**	**3,294**
Net finance income/(cost)	30	31	158	243	364
Finance income	168	187	210	287	404
Finance expenses	-138	-156	-52	-44	-41
Other gains/(losses)	54	67	87	105	119
Profit of JV and associates	0	0	0	0	0
Pretax profit	**963**	**1,493**	**2,577**	**3,242**	**3,776**
Income tax	-126	-195	-387	-486	-566
After tax profit	**837**	**1,298**	**2,190**	**2,756**	**3,210**
MI	-0	-2	-4	-6	-6
Net profit	**837**	**1,296**	**2,186**	**2,750**	**3,204**
D&A	232	264	293	317	341
EBITDA	**1,110**	**1,659**	**2,624**	**3,211**	**3,635**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	963	1,493	2,577	3,242	3,776
Finance cost	-32	-33	52	44	41
Profit or loss of associates	0	0	0	0	0
Loss/(gain) on disposal PP&E/business	3	1	0	0	0
Depreciation & amortization	232	264	293	317	341
Income tax paid	-337	-375	-387	-486	-566
Change in working capital	-345	66	-725	-281	-482
Others	332	253	0	0	0
Cash flow from operation	**799**	**1,660**	**1,809**	**2,836**	**3,110**
Net capex on PP&E	-361	-434	-500	-400	-400
Investment in JV/associates	0	0	0	0	0
Investment in subsidiaries	-117	0	0	0	0
Investment in intangibles	-19	-4	-10	-10	0
Dividend received JV/associates	0	0	0	0	0
Others	216	-14	0	0	0
Cash flow from investing	**-281**	**-452**	**-510**	**-410**	**-400**
Proceeds from equity financing/(repurchase)	0	0	0	0	0
Net bank borrowings	-8	-100	-150	-150	0
Dividend paid	-139	-265	-529	-874	-1,100
Interest paid	-3	-107	-52	-44	-41
Others	-1	18	0	0	0
Cash flow from financing	**-152**	**-454**	**-731**	**-1,069**	**-1,141**
Change in cash	366	754	568	1,357	1,569
Cash at beginning of the year	1,146	1,571	2,343	2,912	4,269
Exchange and others	59	18	0	0	0
Cash at the end of the year	1,571	2,343	2,912	4,269	5,838

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	**2,828**	**2,935**	**3,153**	**3,246**	**3,305**
PP&E	2,233	2,364	2,583	2,678	2,748
JV/associates	0	0	0	0	0
Goodwill	0	0	0	0	0
Intangible assets	279	273	272	270	258
AFS investments	10	0	0	0	0
Others	257	257	257	257	257
Deferred tax assets	49	41	41	41	41
Current assets	**4,443**	**5,492**	**7,090**	**8,800**	**11,078**
Inventories	1,050	997	1,535	1,501	1,936
Trade and bill receivables	1,328	1,639	2,131	2,517	2,792
Prepayment	135	98	98	98	98
Others	358	414	414	414	414
Pledged deposits	0	0	0	0	0
Cash	1,571	2,343	2,912	4,269	5,838
Current liabilities	**1,981**	**2,170**	**2,375**	**2,346**	**2,574**
Trade and bill payables	691	791	1,096	1,167	1,395
Bank borrowings	905	937	837	737	737
Tax payable	24	62	62	62	62
Advance from customers	154	192	192	192	192
Others	208	188	188	188	188
Non-current liabilities	**715**	**643**	**593**	**543**	**543**
Bank borrowings	353	200	150	100	100
Deferred tax liabilities	47	70	70	70	70
Deferred income	165	223	223	223	223
Others	150	150	150	150	150
Equity	**4,575**	**5,614**	**7,275**	**9,157**	**11,267**
Shareholders' equity	4,547	5,584	7,241	9,117	11,220
MI	28	30	35	40	47

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Cylinder for excavator	43%	40%	40%	38%	35%
Cylinder for heavy equipment	27%	25%	23%	21%	21%
Hydraulic pump and valve	11%	21%	25%	29%	32%
Completed set of equipment	5%	3%	3%	3%	3%
Component	13%	9%	9%	9%	9%
Other business	1%	0%	0%	0%	0%
Total revenue	100%	100%	100%	100%	100%
Profit & loss ratio (%)					
Gross margin	36.6	37.8	42.0	42.4	42.3
EBIT margin	20.9	25.8	32.2	33.1	33.3
Net profit margin	19.9	24.0	30.2	31.5	32.5
Growth (%)					
Revenue	50.6	28.6	33.8	20.7	13.0
Gross profit	67.9	32.7	48.8	21.9	12.8
EBIT	90.9	58.7	67.2	24.1	13.8
Net profit	119.1	54.9	68.6	25.8	16.5
Balance sheet ratio					
Current ratio (x)	2.2	2.5	3.0	3.8	4.3
Receivable turnover days	100	100	95	97	98
Inventory turnover days	128	111	110	110	110
Payable turnover days	82	80	82	82	82
Net debt / total equity (%)	Net .	Net .	Net .	Net .	Net .
Profitability (%)					
ROA	12.5	16.5	23.4	24.7	24.2
ROE	19.9	25.6	34.1	33.6	31.5
Per share data					
EPS (RMB)	0.64	0.99	1.67	2.11	2.45
BVPS (RMB)	3.48	4.28	5.55	6.98	8.60
DPS (RMB)	0.20	0.41	0.67	0.84	0.98

Source: Company data, CMBIS estimates

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