

Jiangsu Hengli Hydraulic (601100 CH)

2020E earnings above market expectation; Solid structural growth story

Hengli's released a positive profit alert yesterday stating that the net profit in 2020E is expected to surge 58%-77% YoY to RMB2.05-2.30bn. The mid-point (RMB2.17bn) is in line with our estimate of RMB2.18bn but higher than the consensus of RMB2.06bn. We believe it is a positive surprise to the market. We revised up Hengli's earnings forecast in 2021E/22E by 4%/6% (9%/7% above consensus), after revising up our sales volume assumption. We believe the next catalyst will come from a strong 1Q21E sales. We raise our TP to RMB143, based on 65x 2021E P/E (50% premium to the historical average of 43x).

- Profit surprise in 2020E.** Hengli's net profit in 2020E is expected to surge 58%-77% YoY to RMB2.05-2.3bn. This implies net profit of RMB575-828mn in 4Q20, up 52%-118% YoY. The earnings growth was driven by strong downstream demand (excavator) that boosted the sales of hydraulic cylinders, pump and valve, market share gain, as well as the reduction of SG&A expense ratio.
- We forecast a solid growth of excavator demand in 2021E.** For the industry as a whole, major manufacturers of excavator delivered sales volume of 328k units in 2020, up 39% YoY, according to CCMA. In 4Q20, excavator sales grew 61% YoY. In 2021E, we expect excavator demand to grow 10% YoY (industry), driven by infrastructure spending growth, continuous trend of the substitution of labour and wheel loaders.
- We expect Hengli to deliver strong sales in 1Q21E.** We estimate Hengli production volume of hydraulic cylinder (for excavator) surged 75% YoY in Jan. Besides, we expect the production volume of pump, valve and motor to remain strong. Based on our new assumptions, we forecast Hengli's sales volume of hydraulic cylinder (for excavator) to grow 20% YoY in 2021E, while sales volume of pump and valve to grow 40% YoY.
- Structural growth trajectory remains solid.** We forecast Hengli's market share in hydraulic cylinder to increase from 50% in 2020E to 59% in 2022E. Besides, we expect pump & valve for large-size excavators, as well as non-standardized hydraulic components for various industries will serve as key drivers over the coming few years.
- 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	9,094	10,456
YoY growth (%)	50.6	28.6	33.8	25.6	15.0
Net income (RMB mn)	837	1,296	2,186	2,868	3,387
EPS (RMB)	0.64	0.99	1.67	2.20	2.59
YoY growth (%)	119.1	54.9	68.6	31.2	18.1
Consensus EPS (RMB)	NA	NA	1.58	2.01	2.43
EV/EBITDA (x)	136.8	91.5	57.9	45.3	39.5
P/E (x)	183.7	118.6	70.3	53.6	45.4
P/B (x)	33.8	27.5	21.2	16.6	13.4
Yield (%)	0.2	0.3	0.6	0.7	0.9
ROE (%)	19.9	25.6	34.1	34.8	32.7
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price: RMB143.00
(Previous TP) RMB114.40
Up/Downside: +21%
Current Price: RMB117.75

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Stock Data

Mkt Cap (RMB mn)	153,706
Avg 3 mths t/o (RMB mn)	648
52w High/Low (RMB)	137.66/29.24
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

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

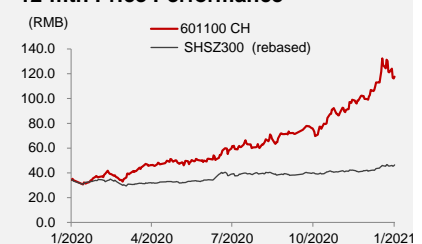
Source: Company data

Share Performance

	Absolute	Relative
1-mth	16.6%	6.5%
3-mth	53.1%	34.0%
6-mth	95.0%	66.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

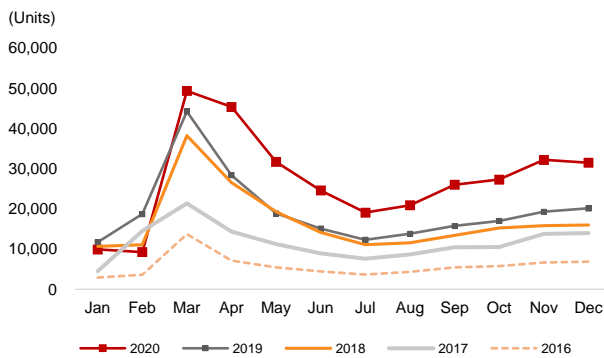
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- Jiangsu Hengli Hydraulic (601100 CH, BUY) – Solid share gain story for both short and long-term; Raise earnings est. & TP – 11 Dec 2020
- Jiangsu Hengli Hydraulic (601100 CH, BUY) – Expect a strong 3Q; Robust demand in Oct;; Raised estimate & TP – 12 Oct 2020
- China Construction Machinery Sector – Four Structural drivers to extend the upcycle to 2020-22E – 27 Nov 2019

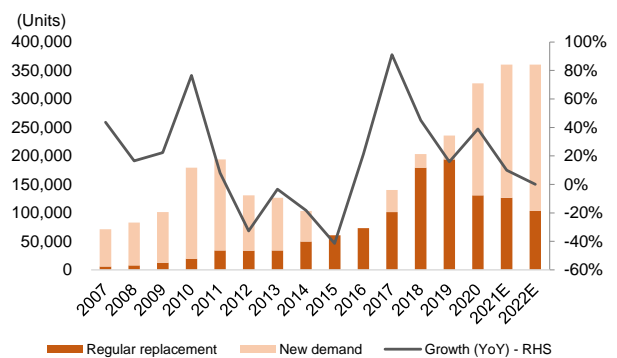
Figure 1: Change in key assumptions

(RMB mn)	Old			New			Change		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Revenue									
Hydraulic cylinder for excavator	2,906	3,299	3,497	2,906	3,566	3,851	0.0%	8.1%	10.1%
Specialised hydraulic cylinder for heavy equipment	1,650	1,876	2,040	1,650	1,958	2,129	0.0%	4.3%	4.3%
Hydraulic pump and valve	1,800	2,520	3,150	1,800	2,520	3,276	0.0%	0.0%	4.0%
Completed set of equipment	217	250	280	217	250	280	0.0%	0.0%	0.0%
Component	651	782	899	651	782	899	0.0%	0.0%	0.0%
Revenue (hydraulic business)	7,225	8,727	9,866	7,225	9,076	10,435	0.0%	4.0%	5.8%
Other business	18	19	21	18	19	21	0.0%	0.0%	0.0%
Total revenue	7,242	8,745	9,886	7,242	9,094	10,456	0.0%	4.0%	5.8%
Gross margin									
Hydraulic cylinder for excavator	44.7%	44.7%	44.5%	44.7%	44.7%	44.5%	0.0	0.0	0.0
Specialised hydraulic cylinder for heavy equipment	41.0%	41.0%	41.0%	41.0%	41.0%	41.0%	0.0	0.0	0.0
Hydraulic pump and valve	43.0%	44.0%	44.0%	43.0%	44.0%	44.0%	0.0	0.0	0.0
Completed set of equipment	33.0%	34.0%	34.0%	33.0%	34.0%	34.0%	0.0	0.0	0.0
Component	32.0%	33.0%	33.0%	32.0%	33.0%	33.0%	0.0	0.0	0.0
Gross margin (hydraulic business)	41.9%	42.3%	42.3%	41.9%	42.4%	42.4%	0.0	0.1	0.1
Other business	66.0%	66.0%	66.0%	66.0%	66.0%	66.0%	0.0	0.0	0.0
Average gross margin	42.0%	42.4%	42.3%	42.0%	42.5%	42.4%	0.0	0.1	0.1
Net profit	2,186	2,750	3,204	2,186	2,868	3,387	0.0%	4.3%	5.7%

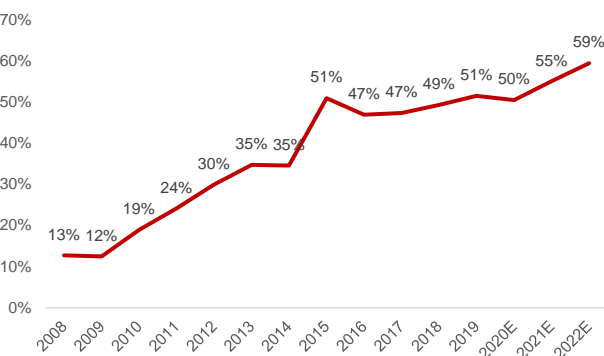
Source: Company data, CMBIS estimates

Figure 2: Excavator monthly sales volume (industry)

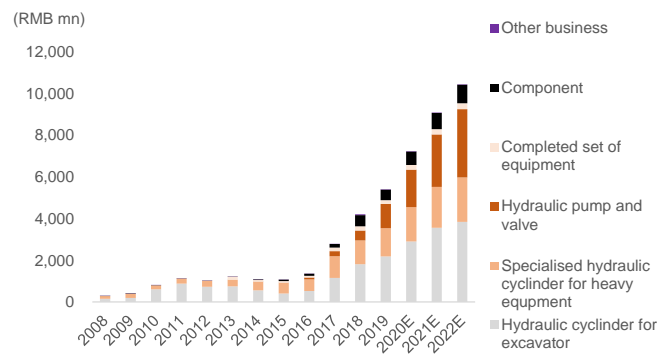
Source: CCMA, CMBIS

Figure 3: CMBIS excavator sales projection (industry)

Source: Company data, CMBIS estimates

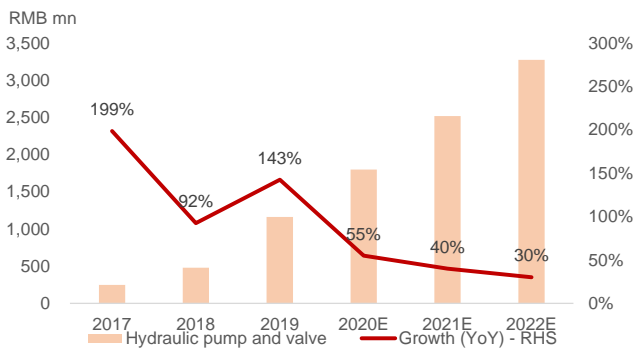
Figure 4: Hengli's market share in hydraulic cylinder for excavator

Source: Company data, CMBIS estimates

Figure 5: Hengli's revenue breakdown

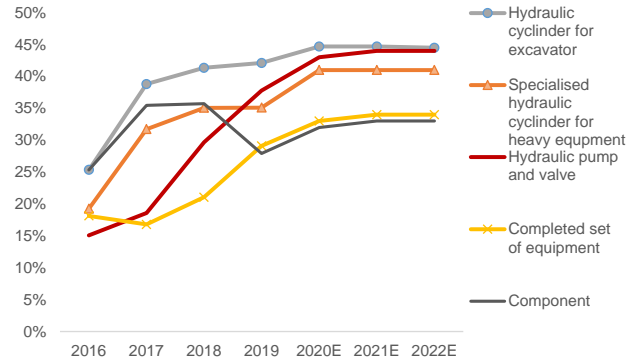
Source: Company data, CMBIS estimates

Figure 6: Hengli's revenue of pump & valves



Source: Company data, CMBIS estimates

Figure 7: Gross margin by segment

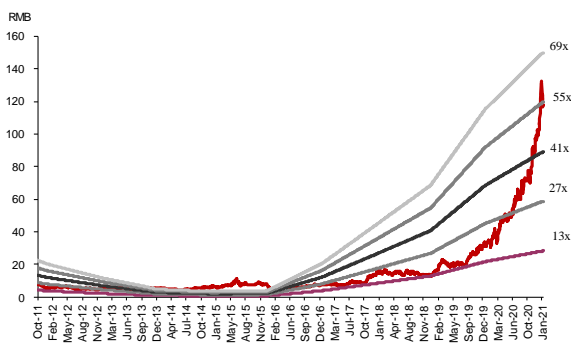


Source: Company data, CMBIS estimates

Valuation

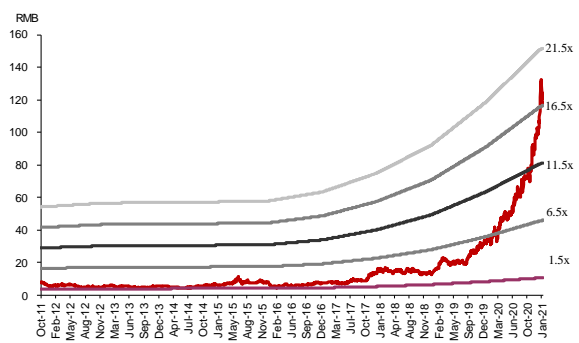
We raise our TP to RMB143 from RMB114.4, based on 65x 2021E P/E (50% premium to the historical average of 43x), up from 55x previously. We continue to believe that a valuation premium is justified due to improving earnings visibility. First, the competitive landscape is favourable for Hengli to achieve further import substitution across different products. Second, Hengli's growth has become incrementally more structural rather than cyclical. We believe the re-rating will continue and the turning point will only emerge when the room of import substitution becomes limited, which we expect is less likely to happen in 2021E.

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						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	7,242	9,094	10,456	Pretax profit	963	1,493	2,577	3,381	3,993
Cost of sales	(2,671)	(3,369)	(4,201)	(5,233)	(6,022)	Finance cost	(32)	(33)	52	44	41
Gross profit	1,540	2,045	3,041	3,861	4,434	Profit or loss of associates	0	0	0	0	0
Surcharge	(43)	(52)	(72)	(91)	(105)	Loss/(gain) on disposal	3	1	0	0	0
S&D expenses	(115)	(111)	(145)	(173)	(199)	Depreciation & amortization	232	264	293	317	341
Administrative expenses	(385)	(435)	(492)	(564)	(627)	Income tax paid	(337)	(375)	(387)	(507)	(599)
Asset impairment	(119)	(52)	0	0	0	Change in working capital	(345)	66	(725)	(497)	(405)
EBIT	879	1,395	2,332	3,033	3,503	Others	332	253	0	0	0
Net finance income/(cost)	30	31	158	239	364	Cash flow from operation	799	1,660	1,809	2,739	3,370
Finance income	168	187	210	283	405	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	87	109	125	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	2,577	3,381	3,993	Dividend received	0	0	0	0	0
Income tax	(126)	(195)	(387)	(507)	(599)	Others	216	(14)	0	0	0
After tax profit	837	1,298	2,190	2,874	3,394	Cash flow from investing	(281)	(452)	(510)	(410)	(400)
MI	(0)	(2)	(4)	(6)	(7)	Equity financing/(repurchase)	0	0	0	0	0
Net profit	837	1,296	2,186	2,868	3,387	Net bank borrowings	(8)	(100)	(150)	(150)	0
						Dividend paid	(139)	(265)	(529)	(874)	(1,147)
D&A	232	264	293	317	341	Interest paid	(3)	(107)	(52)	(44)	(41)
EBITDA	1,110	1,659	2,624	3,350	3,844	Others	(1)	18	0	0	0
						Cash flow from financing	(152)	(454)	(731)	(1,069)	(1,188)
						Change in cash	366	754	568	1,260	1,782
						Cash at beginning of the year	1,146	1,571	2,343	2,912	4,172
						Exchange and others	59	18	0	0	0
						Cash at the end of the year	1,571	2,343	2,912	4,172	5,954

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%	40%	39%	37%
JV/associates	0	0	0	0	0	Cylinder for heavy equipment	27%	25%	23%	22%	20%
Goodwill	0	0	0	0	0	Hydraulic pump and valve	11%	21%	25%	28%	31%
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	7,090	9,006	11,389	Profit & loss ratio (%)					
Inventories	1,050	997	1,535	1,619	2,010	Gross margin	36.6	37.8	42.0	42.5	42.4
Trade and bill receivables	1,328	1,639	2,131	2,702	2,912	EBIT margin	20.9	25.8	32.2	33.4	33.5
Prepayment	135	98	98	98	98	Net profit margin	19.9	24.0	30.2	31.6	32.5
Others	358	414	414	414	414	Growth (%)					
Pledged deposits	0	0	0	0	0	Revenue	50.6	28.6	33.8	25.6	15.0
Cash	1,571	2,343	2,912	4,172	5,954	Gross profit	67.9	32.7	48.8	26.9	14.8
Current liabilities	1,981	2,170	2,375	2,434	2,629	EBIT	90.9	58.7	67.2	30.1	15.5
Trade and bill payables	691	791	1,096	1,255	1,451	Net profit	119.1	54.9	68.6	31.2	18.1
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	3.7	4.3
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 cash	Net cash	Net cash	Net cash	Net cash
Deferred tax liabilities	47	70	70	70	70	Profitability (%)					
Deferred income	165	223	223	223	223	ROA	12.5	16.5	23.4	25.5	25.1
Others	150	150	150	150	150	ROE	19.9	25.6	34.1	34.8	32.7
Equity	4,575	5,614	7,275	9,275	11,522	Per share data					
Shareholders' equity	4,547	5,584	7,241	9,235	11,474	EPS (RMB)	0.64	0.99	1.67	2.20	2.59
MI	28	30	35	41	47	BVPS (RMB)	3.48	4.28	5.55	7.07	8.79
						DPS (RMB)	0.20	0.41	0.67	0.88	1.04

Source: Company data, CMBIS estimates

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