

Jiangsu Hengli Hydraulic (601100 CH)

Short-term impact of power outage; Wait for more positive signals

We expect Hengli's production plan in Oct will be affected by the current power shortage, resulting in a slower-than-expected sales recovery in 4Q21E. We trim our earnings forecast in 2021E by 8%, to reflect lower volume and margin assumptions. We also revise down our earnings forecast by 4% each year in 2022E/23E to reflect our more conservative margin assumptions. Our TP is revised down from RMB103 to RMB86, based on 42x 2021E P/E which is equivalent to the historical average (previous target P/E: 46x). Maintain **HOLD**.

- Scheduled production in Oct is affected by power shortage.** Hengli has scheduled production volume of 66k units of excavator hydraulic cylinder in Oct (up only 5% YoY but down 6% MoM), which is below our expectation. Scheduled production volume of large & medium size pump/valves also slowed to 8%/19% growth (YoY) in Oct. The conservative production plan is due to the uncertainties arising from power suspension.
- 3Q21E earnings preview.** Hengli will report the 3Q21E results on 25 Oct. We forecast net profit to slightly drop 3% YoY to RMB471mn, due to margin contraction that offset the revenue growth of 13%.
- New business initiatives to drive diversification in terms of product offerings and international expansion.** Hengli is planning for a placement with a fund-raising size of RMB5bn (max). The proceeds will be mainly spent on the capacity expansion in Mexico (to support the global leading excavator manufacturer), as well as the new capacity of linear actuator for electric cylinder (a new area for potential import substitution). We are positive to Hengli's new business initiatives, given the excellent track record of achieving import substitution in the hydraulic cylinder, pump and valve.
- Upside risks:** (1) Fast recovery of power supply; (2) better-than-expected excavator demand. **Downside risks:** (1) Continuous slowdown of construction activities; (2) longer-than-expected power suspension (3) risk of overseas expansion.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	5,414	7,855	9,854	10,883	11,601
YoY growth (%)	28.6	45.1	25.5	10.4	6.6
Net income (RMB mn)	1,296	2,254	2,686	3,173	3,563
EPS (RMB)	0.99	1.73	2.06	2.43	2.73
YoY growth (%)	54.9	73.9	19.2	18.1	12.3
Consensus EPS (RMB)	NA	NA	2.20	2.61	3.06
EV/EBITDA (x)	64.7	35.8	32.5	28.8	26.4
P/E (x)	84.2	48.4	40.6	34.4	30.6
P/B (x)	19.5	14.9	11.8	9.5	7.8
Yield (%)	0.5	0.7	0.9	1.0	1.1
ROE (%)	25.6	35.0	32.5	30.7	28.1
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price: RMB86.00
(Previous TP) RMB103.00
Up/Downside: +3%
Current Price: RMB83.57

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Stock Data

Mkt Cap (RMB mn)	109,089
Avg 3 mths t/o (RMB mn)	937
52w High/Low (RMB)	137.66/67.50
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

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

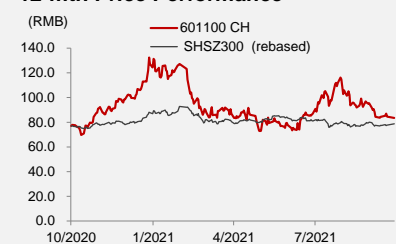
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-12.5%	-11.0%
3-mth	-3.9%	-1.2%
6-mth	-3.9%	-1.8%

Source: Bloomberg

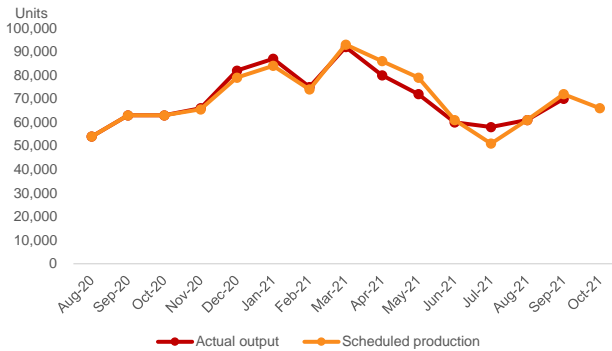
12-mth Price Performance



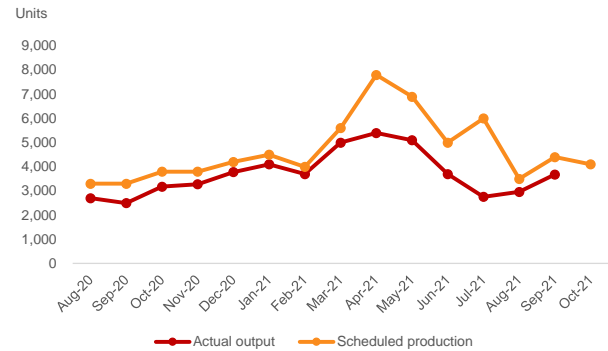
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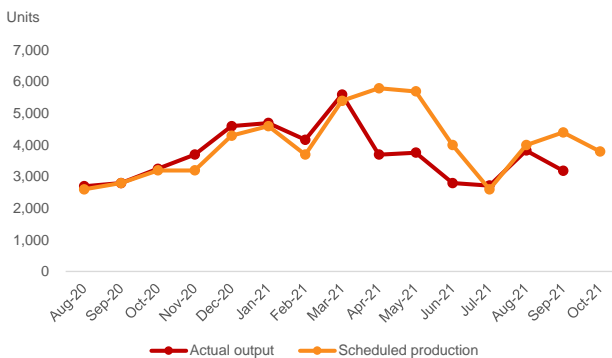
- Jiangsu Hengli Hydraulic – Net profit in 2Q21 down only 2% YoY; better than expectations – 24 Aug 2021
- Construction Machinery / HDT (Outperform) – Favourable policy shift; Defensive growth amid volatile market; Upgrade SANY Heavy & Sinotruk – 9 Aug 2021

Figure 1: Hengli's hydraulic cylinders monthly production

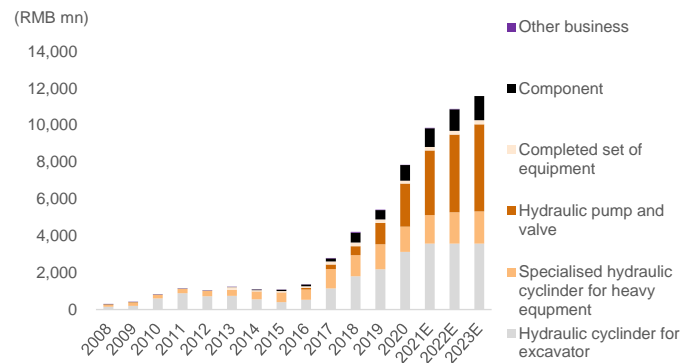
Source: Company data, CMBIS estimates

Figure 2: Hengli's large & medium size pump monthly production

Source: Company data, CMBIS estimates

Figure 3: Hengli's hydraulic cylinders monthly production

Source: Company data, CMBIS estimates

Figure 4: Hengli's revenue breakdown

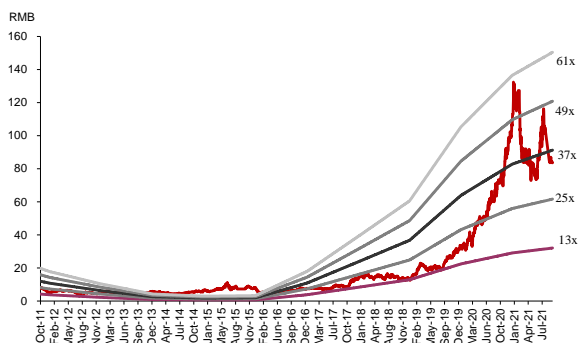
Source: Company data, CMBIS estimates

Figure 5: Change in key assumptions

(RMB mn)	Old			New			Change		
	2021E	2022E	2023E	2021E	2022E	2023E	2021E	2022E	2023E
Revenue									
Hydraulic cylinder for excavator	3,645	3,645	3,645	3,582	3,582	3,582	-1.7%	-1.7%	-1.7%
Specialised hydraulic cylinder for heavy equipment	1,563	1,720	1,771	1,539	1,693	1,744	-1.5%	-1.5%	-1.5%
Hydraulic pump and valve	3,624	4,168	4,585	3,508	4,209	4,714	-3.2%	1.0%	2.8%
Hydraulic system	196	216	237	191	211	232	-2.4%	-2.4%	-2.4%
Component	1,015	1,167	1,307	1,015	1,167	1,307	0.0%	0.0%	0.0%
Revenue (hydraulic business)	10,044	10,916	11,546	9,835	10,862	11,579	-2.1%	-0.5%	0.3%
Other business	19	21	22	19	21	22	0.0%	0.0%	0.0%
Total revenue	10,063	10,936	11,567	9,854	10,883	11,601	-2.1%	-0.5%	0.3%
Gross margin									
Hydraulic cylinder for excavator	41.0%	41.0%	41.0%	40.5%	40.5%	40.5%	-0.5	-0.5	-0.5
Specialised hydraulic cylinder for heavy equipment	39.0%	39.0%	39.0%	39.0%	39.0%	39.0%	0.0	0.0	0.0
Hydraulic pump and valve	44.0%	43.0%	43.0%	43.0%	43.0%	43.0%	-1.0	0.0	0.0
Hydraulic system	35.0%	35.0%	34.0%	35.0%	35.0%	34.0%	0.0	0.0	0.0
Component	20.0%	25.0%	33.0%	20.0%	25.0%	33.0%	0.0	0.0	0.0
Gross margin (hydraulic business)	39.5%	39.6%	40.4%	38.9%	39.5%	40.3%	-0.6	-0.2	-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	39.6%	39.7%	40.5%	39.0%	39.5%	40.4%	-0.6	-0.2	-0.1
							<i>Change (ppt)</i>		
S&D expense ratio	-1.2%	-1.2%	-1.2%	-1.1%	-1.1%	-1.1%	0.1	0.1	0.1
Admin expense and R&D ratio	-6.2%	-6.1%	-6.0%	-6.9%	-6.7%	-6.7%	-0.7	-0.6	-0.7
Net profit	2,932	3,307	3,713	2,716	3,237	3,652	-7.4%	-2.1%	-1.7%

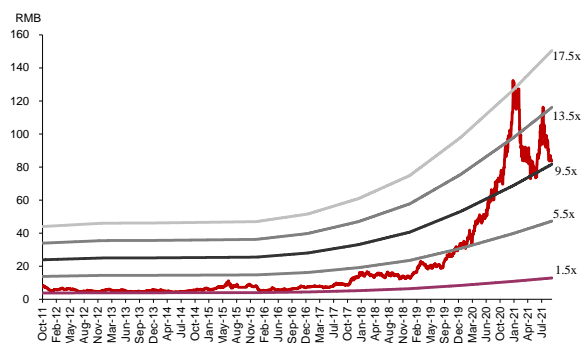
Source: Company data, CMBIS estimates

Figure 6: Hengli's P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 7: Hengli's P/B band



Source: Bloomberg, Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	5,414	7,855	9,854	10,883	11,601	Pretax profit	1,493	2,609	3,129	3,697	4,152
Cost of sales	(3,369)	(4,391)	(6,012)	(6,583)	(6,918)	Finance cost	-33	146	109	68	68
Gross profit	2,045	3,464	3,842	4,300	4,683	Profit or loss of associates	0	0	0	0	0
Surcharge	(52)	(72)	(89)	(98)	(104)	Loss/(gain) on disposal	1	1	0	0	0
S&D expenses	(111)	(107)	(108)	(120)	(128)	Depreciation & amortization	264	311	338	369	394
Administrative expenses	(435)	(509)	(680)	(729)	(777)	Income tax paid	-375	-714	-438	-518	-581
Asset impairment	(52)	(90)	0	0	0	Change in working capital	66	-849	-321	-64	-181
EBIT	1,395	2,687	2,965	3,353	3,673	Others	253	488	0	0	0
Net finance income/(cost)	31	(151)	131	309	465	Cash flow from operation	1,660	1,981	2,818	3,552	3,852
Finance income	187	223	239	357	511	Net capex on PP&E	-434	-380	-500	-500	-400
Finance expenses	(156)	(375)	(109)	(48)	(46)	Investment in JV/associates	0	0	0	0	0
Other gains/(losses)	67	74	69	109	116	Investment in subsidiaries	0	0	0	0	0
Profit of JV and associates	0	0	0	0	0	Investment in intangibles	-4	-19	-20	-20	-20
Pretax profit	1,493	2,609	3,164	3,771	4,255	Dividend received	0	0	0	0	0
Income tax	(195)	(348)	(443)	(528)	(596)	Others	-14	-264	0	0	0
After tax profit	1,298	2,261	2,721	3,243	3,659	Cash flow from investing	-452	-663	-520	-520	-420
MI	(2)	(7)	(5)	(6)	(7)	Equity financing/(repurchase)	0	0	0	0	0
Net profit	1,296	2,254	2,716	3,237	3,652	Net bank borrowings	-100	-361	-150	0	0
						Dividend paid	-265	-529	-783	-940	-1,110
D&A	264	311	338	369	394	Interest paid	-107	-40	-109	-68	-68
EBITDA	1,659	2,997	3,303	3,722	4,067	Others	18	112	0	0	0
						Cash flow from financing	-454	-818	-1,042	-1,008	-1,179
						Change in cash	754	499	1,255	2,024	2,253
						Cash at beginning of the year	1,571	2,343	2,777	4,033	6,056
						Exchange and others	18	-66	0	0	0
						Cash at the end of the year	2,343	2,777	4,033	6,056	8,310

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	2,935	3,025	3,207	3,358	3,384	Sales mix (%)					
PP&E	2,364	2,432	2,608	2,753	2,774	Cylinder for excavator	40%	40%	36%	33%	31%
JV/associates	0	0	0	0	0	Cylinder for heavy equipment	25%	17%	16%	16%	15%
Goodwill	0	0	0	0	0	Hydraulic pump and valve	21%	30%	36%	39%	41%
Intangible assets	273	280	286	292	297	Hydraulic system	3%	2%	2%	2%	2%
AFS investments	0	0	0	0	0	Component	9%	11%	10%	11%	11%
Others	257	261	261	261	261	Other business	0%	0%	0%	0%	0%
Deferred tax assets	41	52	52	52	52	Total revenue	100%	100%	100%	100%	100%
Current assets	5,492	7,595	9,545	11,581	14,218	Profit & loss ratio (%)					
Inventories	997	1,217	1,814	1,468	1,943	Gross margin	37.8	44.1	39.0	39.5	40.4
Trade and bill receivables	1,639	2,705	2,803	3,160	3,069	EBIT margin	25.8	34.2	30.1	30.8	31.7
Prepayment	98	164	164	164	164	Net profit margin	24.0	28.8	27.3	29.2	30.8
Others	414	733	733	733	733	Growth (%)					
Pledged deposits	0	0	0	0	0	Revenue	28.6	45.1	25.5	10.4	6.6
Cash	2,343	2,777	4,033	6,056	8,310	Gross profit	32.7	69.4	10.9	11.9	8.9
Current liabilities	2,170	2,590	2,864	2,812	3,015	EBIT	58.7	92.7	10.3	13.1	9.5
Trade and bill payables	791	1,131	1,505	1,453	1,656	Net profit	54.9	73.9	19.2	18.1	12.3
Bank borrowings	937	554	454	454	454	Balance sheet ratio					
Tax payable	62	119	119	119	119	Current ratio (x)	2.5	2.9	3.3	4.1	4.7
Advance from customers	192	108	108	108	108	Receivable turnover days	100	101	102	100	98
Others	188	677	677	677	677	Inventory turnover days	111	92	92	91	90
Non-current liabilities	643	679	629	629	629	Payable turnover days	80	80	80	82	82
Bank borrowings	200	370	320	320	320	Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Deferred tax liabilities	70	108	108	108	108	Profitability (%)					
Deferred income	223	200	200	200	200	ROA	16.5	23.7	23.0	22.9	21.9
Others	150	0	0	0	0	ROE	25.6	35.0	32.5	30.7	28.1
Equity	5,614	7,352	9,260	11,499	13,959	Per share data					
Shareholders' equity	5,584	7,314	9,216	11,449	13,902	EPS (RMB)	0.99	1.73	2.06	2.43	2.73
MI	30	38	43	50	57	BVPS (RMB)	4.28	5.60	7.06	8.77	10.65
						DPS (RMB)	0.41	0.60	0.72	0.85	0.96

Source: Company data, CMBIS estimates

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