

Jiangsu Hengli Hydraulic (601100 CH)

Recovery weaker-than-expected; Rich valuation along with earnings risk

Hengli's planned production volume remained relatively weak in Feb, due to the sluggish downstream demand and more time needed to digest the inventory of hydraulic pump and valve. We expect the recovery this year will likely be weaker than expectations and we see downside risk to the consensus earnings. We took our earnings forecast in 2021E/22E/23E down by 6%/12%/13% to reflect our more conservative assumptions on sales volume. We think the current valuation is rich at 33x 2022E P/E. We revised our TP down from RMB86 to RMB64, based on 30x 2022E P/E which is equivalent to the 3-year historical average (previous target: 42x 2021E P/E). Maintain **HOLD**. We will be more constructive if we see (1) a meaningful recovery of pump & valves sales; and (2) further progress in the non-construction machinery areas, similar to the agreement signed with Edwards Vacuum (Qingdao) recently.

- 4Q21E earnings preview.** We forecast net profit to drop >30% YoY in 4Q21E, due to the overall weakness of sales volume which resulted in inventory build-up for pump & valve. We expect the full year net profit in 2021E to grow only 12% YoY to ~RMB2.5bn.
- Production plan in Feb 2022:** We expect Hengli has scheduled production volume of 63k units of hydraulic cylinder (excavator), down ~15% YoY. Scheduled production volume of pump/valve drops ~50%/40% YoY, as the process of inventory clearance since 4Q21 has continued to affect the output. On the positive side, we expect the planned production for non-standardized cylinders in Feb to double YoY to 14k units due to a low base. Besides, the planned volume of motor increases >60% YoY and >30% MoM, driven by AWP demand.
- Share placement plan approved by CSRC in mid-Jan.** Hengli is eligible to issue a maximum of 391.6mn new shares (representing 23% of enlarged share capital). The proceeds will be mainly spent on the capacity expansion in Mexico (to support the global leading excavator manufacturer and the Chinese customers in the US). Besides, Hengli will construct new capacity for linear actuator for electric cylinder (a new area that offers huge potential for import substitution). From a longer-term perspective, we remain positive to Hengli's new business initiatives, given the excellent track record of achieving import substitution.
- Upside risks:** (1) Stronger recovery of excavator demand. **Downside risks:** (1) weak recovery of construction activities; (2) risk of overseas expansion.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	5,414	7,855	8,912	9,969	10,586
YoY growth (%)	28.6	45.1	13.5	11.9	6.2
Net income (RMB mn)	1,296	2,254	2,523	2,795	3,090
EPS (RMB)	0.99	1.73	1.93	2.14	2.37
YoY growth (%)	54.9	73.9	11.9	10.8	10.5
Consensus EPS (RMB)	NA	NA	2.08	2.49	2.90
EV/EBITDA (x)	55.1	30.5	29.4	27.6	26.0
P/E (x)	71.9	41.3	36.9	33.3	30.2
P/B (x)	16.7	12.7	10.3	8.5	7.1
Yield (%)	0.6	0.8	0.9	1.0	1.2
ROE (%)	25.6	35.0	30.8	27.9	25.7
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price: **RMB64.00**
 (Previous TP **RMB86.00**)
 Up/Downside: **-10%**
 Current Price: **RMB71.39**

China Capital Goods

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Stock Data

Mkt Cap (RMB mn)	93,190
Avg 3 mths t/o (RMB mn)	380.43
52w High/Low (RMB)	131.29/67.55
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

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

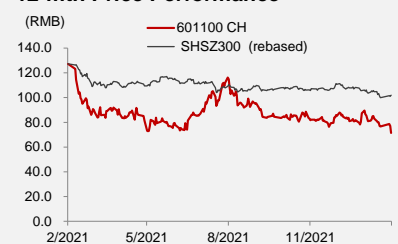
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-18.3%	-15.3%
3-mth	-14.0%	-10.4%
6-mth	-38.6%	-34.2%

Source: Bloomberg

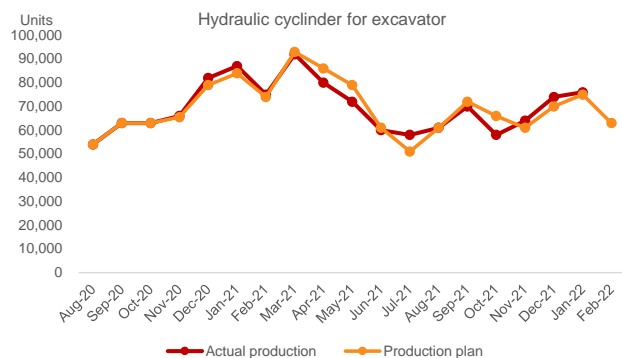
12-mth Price Performance



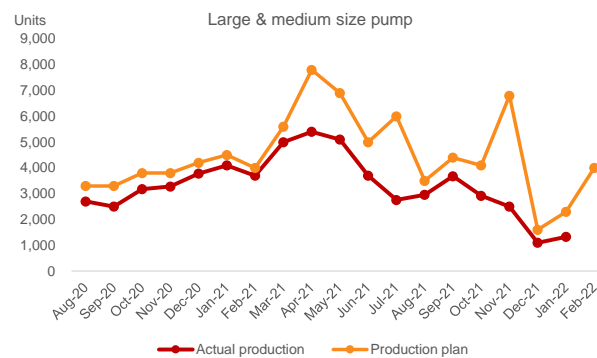
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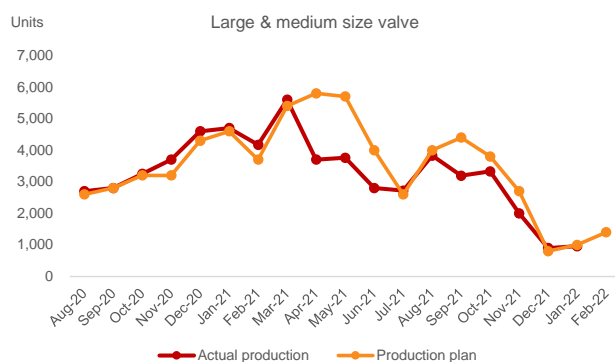
- Jiangsu Hengli Hydraulic – Short-term impact of power outage; Wait for more positive signals – 11 Oct 2021
- Jiangsu Hengli Hydraulic – Net profit in 2Q21 down only 2% YoY; better than expectations – 24 Aug 2021

Figure 1: Hengli's hydraulic cylinders monthly production


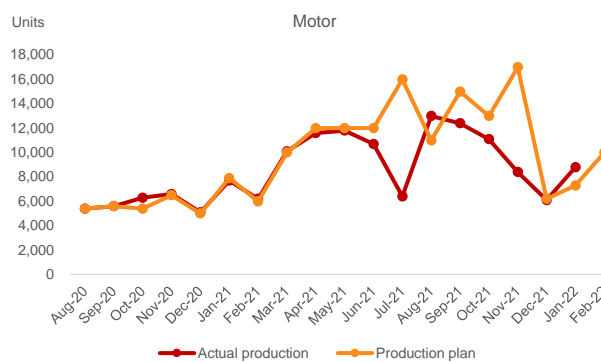
Source: Company data, CMBIS estimates

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


Source: Company data, CMBIS estimates

Figure 3: Hengli's large & medium size valve monthly production


Source: Company data, CMBIS estimates

Figure 4: Hengli's motor monthly production


Source: Company data, CMBIS estimates

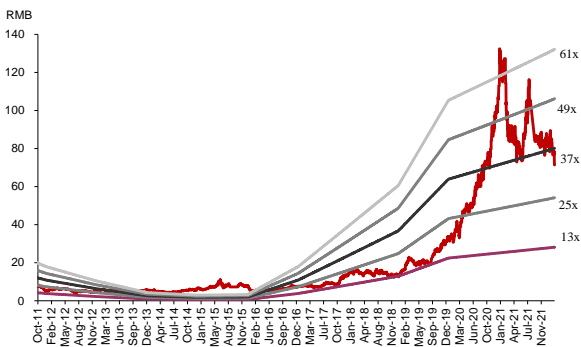
Earnings forecast in 2022E-23E

- We revised down the sales forecast of excavator hydraulic cylinder by 4%, as we believe further market share gain is less likely going forward (currently >50% in China excavator market).
- We revised down our forecast on pump and valve substantially by 42% as we expect it takes time to clear the inventory and the market share gain will slow.
- We revised up the sales forecast on non-standardized cylinder as we expect more applications in the non-excavator areas.
- Hengli signed an agreement in Jan with Edwards Vacuum (Qingdao) “埃地沃兹真空泵制造(青岛)”. Hengli will supply cast metals to Edwards for the production of vacuum pump products applied in the semiconductor, new energy and medical industry (Edwards is a subsidiary of **Atlas Copco Group [ATCOA SS]**, a Sweden-based provider of industrial productivity solutions). We estimate the revenue contribution to be ~RMB200mn this year (~2% of our revenue forecast in 2022E) and will gradually increase alongside the upcoming capex growth in the semiconductor, new energy and medical industry. We include this in our new estimates.

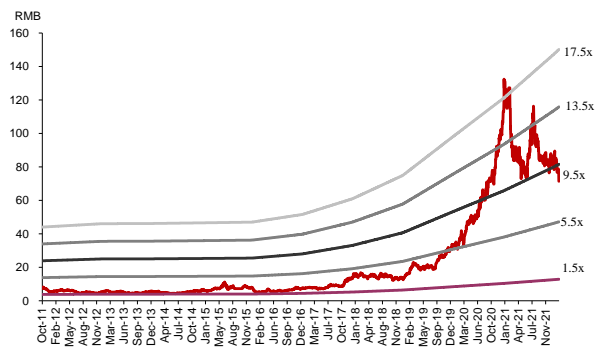
Figure 5: Change in key assumptions

(RMB mn)	Old			New			Change		
	2021E	2022E	2023E	2021E	2022E	2023E	2021E	2022E	2023E
Revenue									
Hydraulic cylinder for excavator	3,582	3,582	3,582	3,758	3,427	3,427	4.9%	-4.4%	-4.4%
Specialised hydraulic cylinder for heavy equipment	1,539	1,693	1,744	1,855	2,189	2,255	20.5%	29.3%	29.3%
Hydraulic pump and valve	3,508	4,209	4,714	1,684	2,441	2,734	-52.0%	-42.0%	-42.0%
Completed set of equipment	191	211	232	235	259	272	23.0%	23.0%	17.4%
Component	1,015	1,167	1,307	1,353	1,623	1,867	33.3%	39.1%	42.9%
Revenue (hydraulic business)	9,835	10,862	11,579	8,885	9,939	10,554	-9.7%	-8.5%	-8.9%
Other business	19	21	22	27	30	32	45.5%	45.5%	45.5%
Total revenue	9,854	10,883	11,601	8,912	9,969	10,586	-9.6%	-8.4%	-8.7%
Gross margin									
Hydraulic cylinder for excavator	40.5%	40.5%	40.5%	43.0%	41.5%	41.0%	2.5	1.0	0.5
Specialised hydraulic cylinder for heavy equipment	39.0%	39.0%	39.0%	46.0%	44.0%	44.0%	7.0	5.0	5.0
Hydraulic pump and valve	43.0%	43.0%	43.0%	43.0%	42.0%	42.0%	0.0	-1.0	-1.0
Completed set of equipment	35.0%	35.0%	34.0%	39.0%	39.0%	38.0%	4.0	4.0	4.0
Component	20.0%	25.0%	33.0%	28.0%	25.0%	27.0%	8.0	0.0	-6.0
Gross margin (hydraulic business)	38.9%	39.5%	40.3%	41.2%	39.4%	39.3%	2.3	0.0	-1.0
Other business	66.0%	66.0%	66.0%	95.0%	90.0%	90.0%	29.0	24.0	24.0
Average gross margin	39.0%	39.5%	40.4%	41.4%	39.6%	39.5%	2.4	0.1	-0.9
							Change (ppt)		
S&D expense ratio	-1.1%	-1.1%	-1.1%	-0.8%	-0.8%	-0.8%	0.3	0.3	0.3
Admin expense and R&D ratio	-6.9%	-6.7%	-6.7%	-8.7%	-8.5%	-8.5%	-1.8	-1.8	-1.8
Net profit	2,686	3,173	3,563	2,523	2,795	3,090	-6.1%	-11.9%	-13.3%

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	8,912	9,969	10,586	Pretax profit	1,493	2,609	2,873	3,183	3,518
Cost of sales	(3,369)	(4,391)	(5,222)	(6,025)	(6,405)	Finance cost	(33)	146	132	104	108
Gross profit	2,045	3,464	3,690	3,944	4,181	Profit or loss of associates	0	0	0	0	0
Surcharge	(52)	(72)	(71)	(80)	(85)	Loss/(gain) on disposal	1	1	0	0	0
S&D expenses	(111)	(107)	(71)	(80)	(85)	Depreciation & amortization	264	311	335	372	409
Administrative expenses	(435)	(509)	(775)	(847)	(900)	Income tax paid	(375)	(714)	(345)	(382)	(422)
Asset impairment	(52)	(90)	0	0	0	Change in working capital	66	(849)	(550)	155	(210)
EBIT	1,395	2,687	2,772	2,938	3,112	Others	253	488	0	0	0
Net finance income/(cost)	31	(151)	38	146	300	Cash flow from operation	1,660	1,981	2,445	3,432	3,403
Finance income	187	223	170	250	409	Net capex on PP&E	(434)	(380)	(450)	(600)	(600)
Finance expenses	(156)	(375)	(132)	(104)	(108)	Investment in JV/associates	0	0	0	0	0
Other gains/(losses)	67	74	62	100	106	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	2,873	3,183	3,518	Dividend received	0	0	0	0	0
Income tax	(195)	(348)	(345)	(382)	(422)	Others	(14)	(264)	0	0	0
After tax profit	1,298	2,261	2,528	2,801	3,096	Cash flow from investing	(452)	(663)	(470)	(620)	(620)
MI	(2)	(7)	(5)	(6)	(6)	Equity financing/(repurchase)	0	0	0	0	0
Net profit	1,296	2,254	2,523	2,795	3,090	Net bank borrowings	(100)	(361)	200	100	0
						Dividend paid	(265)	(529)	(783)	(883)	(978)
D&A	264	311	335	372	409	Interest paid	(107)	(40)	(132)	(104)	(108)
EBITDA	1,659	2,997	3,107	3,310	3,521	Others	18	112	0	0	0
						Cash flow from financing	(454)	(818)	(715)	(887)	(1,087)
						Change in cash	754	499	1,260	1,925	1,696
						Cash at beginning of the year	1,571	2,343	2,777	4,037	5,962
						Exchange and others	18	(66)	0	0	0
						Cash at the end of the year	2,343	2,777	4,037	5,962	7,658

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	3,160	3,408	3,619	Sales mix (%)					
PP&E	2,364	2,432	2,561	2,803	3,009	Cylinder for excavator	40%	40%	42%	34%	32%
JV/associates	0	0	0	0	0	Cylinder for heavy equipment	25%	17%	21%	22%	21%
Goodwill	0	0	0	0	0	Hydraulic pump and valve	21%	30%	19%	24%	26%
Intangible assets	273	280	286	292	297	Hydraulic system	3%	2%	3%	3%	3%
AFS investments	0	0	0	0	0	Component	9%	11%	15%	16%	18%
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	9,433	11,560	13,278	Profit & loss ratio (%)					
Inventories	997	1,217	1,931	1,536	1,974	Gross margin	37.8	44.1	41.4	39.6	39.5
Trade and bill receivables	1,639	2,705	2,569	3,166	2,750	EBIT margin	25.8	34.2	31.1	29.5	29.4
Prepayment	98	164	164	164	164	Net profit margin	24.0	28.8	28.4	28.1	29.2
Others	414	733	733	733	733	Growth (%)					
Pledged deposits	0	0	0	0	0	Revenue	28.6	45.1	13.5	11.9	6.2
Cash	2,343	2,777	4,037	5,962	7,658	Gross profit	32.7	69.4	6.5	6.9	6.0
Current liabilities	2,170	2,590	2,668	3,125	2,936	EBIT	58.7	92.7	3.2	6.0	5.9
Trade and bill payables	791	1,131	1,159	1,515	1,327	Net profit	54.9	73.9	11.9	10.8	10.5
Bank borrowings	937	554	604	704	704	Balance sheet ratio					
Tax payable	62	119	119	119	119	Current ratio (x)	2.5	2.9	3.5	3.7	4.5
Advance from customers	192	108	108	108	108	Receivable turnover days	100	101	108	105	102
Others	188	677	677	677	677	Inventory turnover days	111	92	110	105	100
Non-current liabilities	643	679	829	829	829	Payable turnover days	80	80	80	81	81
Bank borrowings	200	370	520	520	520	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	21.7	20.3	19.4
Others	150	0	0	0	0	ROE	25.6	35.0	30.8	27.9	25.7
Equity	5,614	7,352	9,096	11,014	13,132	Per share data					
Shareholders' equity	5,584	7,314	9,053	10,966	13,077	EPS (RMB)	0.99	1.73	1.93	2.14	2.37
MI	30	38	43	49	55	BVPS (RMB)	4.28	5.60	6.94	8.40	10.02
						DPS (RMB)	0.41	0.60	0.68	0.75	0.83

Source: Company data, CMBIS estimates

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