Jiangsu Hengli Hydraulic (601100 CH)

2Q Net profit +85% YoY; Significant margin expansion

Hengli's net profit in 1H20 grew 47% YoY to RMB986mn, implying an impressive net profit growth of 85% YoY in 2Q. Gross margin of 44.5% in 2Q is a record high, suggesting high utilization rate and strong pricing power. We revised up our earnings forecast in 2020E-22E by 5-8% (12-15% above consensus), after incorporating higher gross margin assumption and lower expense ratios. After rolling over the valuation base to 2021E, we raised our TP to RMB82 based on unchanged multiple of 45x P/E. We believe the fast-growing pump and valve sales will continue to lend support to the valuation. Maintain **BUY**.

- **Key highlights on 1H20 results.** Revenue grew 24% YoY to RMB3.46bn and gross margin significantly expanded 4.9ppt YoY to 41.9%. This, coupled with lower SG&A ratios, boosted the net profit growth of 47% YoY. Operating cash inflow in 1H20 increased by 19% YoY to RMB944mn. In 2Q20, net profit surged 85% YoY to RMB639mn, mainly driven by 71% YoY increase in revenue and 4.6ppt YoY gross margin expansion (to 44.5%).
- **Solid sales growth in 1H20.** Sales volume of hydraulic cylinder for excavator grew 27% YoY 330k units. The segment revenue grew 16% YoY to RMB1.4bn, a result of lower ASP due to higher demand for small-size excavators. Hydraulic Technology, the major subsidiary with a focus on hydraulic pump and valve, reported revenue growth of 86% YoY. Revenue of non-standardized hydraulic cylinders dropped 9% YoY to RMB577mn.
- **Production volume staying high in Jul & Aug**. Based on our understanding, Hengli's monthly production volume reached 53k units in Jul and is expected to reach 54k units in Aug. Such monthly volume suggests strong downstream demand. Besides, production volume of pumps and valves are expected to stay high in 3Q.
- **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	6,964	8,164	9,144
YoY growth (%)	50.6	28.6	28.6	17.2	12.0
Net income (RMB mn)	837	1,296	1,963	2,380	2,743
EPS (RMB)	0.64	0.99	1.50	1.82	2.10
YoY growth (%)	119.1	54.9	51.5	21.2	15.3
Consensus EPS (RMB)	NA	NA	1.30	1.60	1.88
EV/EBITDA (x)	74.3	49.7	34.4	29.1	26.0
P/E (x)	98.3	63.4	41.9	34.6	30.0
P/B (x)	18.1	14.7	11.7	9.5	7.9
Yield (%)	0.3	0.6	1.0	1.2	1.3
ROE (%)	19.9	25.6	31.2	30.5	28.9
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price:	**RMB82.00**
(Previous TP	RMB62.84)
Up/Downside:	**+30%**
Current Price:	**RMB63.00**

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Stock Data

Mkt Cap (RMB mn)	82,238
Avg 3 mths t/o (RMB mn)	395
52w High/Low (RMB)	66.59/18.93
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

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

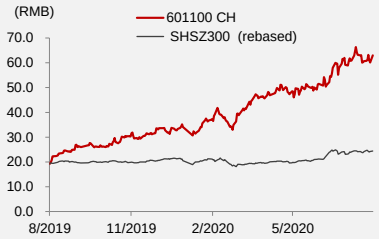
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-3.0%	-3.1%
3-mth	27.1%	3.0%
6-mth	63.7%	43.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: RSM

1. China Construction Machinery Sector – Sustainable demand for excavator in 2H20E – 12 Aug 2020
2. China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020

Figure 1: Quarterly highlights

(RMB mn)	1Q19	1Q20	Change YoY	2Q19	2Q20	Change YoY
Total revenue	**1,569**	**1,369**	***-12.7%***	**1,224**	**2,087**	***70.5%***
Cost of sales	-1,023	-850	*-16.9%*	-736	-1,159	*57.6%*
Gross profit	**546**	**518**	***-5.0%***	**488**	**928**	***90.0%***
Other income	-15	-13	*-8.5%*	-11	-23	*111.3%*
S&D expenses	-19	-26	*35.6%*	-29	-29	*-0.7%*
Administrative expenses	-95	-97	*2.5%*	-113	-108	*-4.3%*
Asset impairment	-21	-18	*-12.7%*	8	-24	*n/a*
EBIT	**395**	**363**	***-8.3%***	**344**	**744**	***116.5%***
Net finance income/(cost)	-35	37	*n/a*	50	-3	*n/a*
Other gains/(loss)	13	18	*36.3%*	12	18	*50.6%*
Profit of JV & associates	0	0	*n/a*	0	0	*n/a*
Pretax profit	**373**	**418**	***12.1%***	**405**	**759**	***87.2%***
Income tax	-47	-70	*51.1%*	-60	-118	*97.2%*
After tax profit	**327**	**348**	*6.5%*	**345**	**641**	*85.5%*
MI	-0	-1	*32.8%*	-1	-2	*156.4%*
Net profit	**326**	**347**	***6.5%***	**345**	**639**	***85.4%***
Key ratios			*ppt*			*ppt*
Gross margin	*34.8%*	*37.9%*	*3.1*	*39.9%*	*44.5%*	*4.6*
S&D expense ratio	*1.2%*	*1.9%*	*0.7*	*2.4%*	*1.4%*	*-1.0*
Adminstrative and R&D exp ratio	*6.1%*	*7.1%*	*1.1*	*9.2%*	*5.2%*	*-4.1*
Effective tax rate	*12.5%*	*16.8%*	*4.3*	*14.8%*	*15.6%*	*0.8*

Source: Company data, CMBIS estimates

Figure 2: 1H20 results highlights

YE Dec 31(RMB mn)	1H19	1H20	Change (YoY)
Total revenue	**2,793**	**3,456**	***23.8%***
Cost of sales	-1,759	-2,009	*14.3%*
Gross profit	**1,034**	**1,446**	***39.9%***
Surcharge	-25	-36	*42.1%*
S&D expenses	-48	-55	*13.9%*
Administrative expenses	-208	-205	*-1.2%*
Asset impairment	-13	-43	*227.3%*
EBIT	**739**	**1,107**	***49.8%***
Net finance income/(cost)	14	34	*139.9%*
Finance income	103	97	*-5.2%*
Finance expenses	-88	-63	*-28.8%*
Other gains/(losses)	25	36	*43.0%*
Share of profit of JV and associates	0	0	*n/a*
Pretax profit	**778**	**1,177**	***51.2%***
Income tax	-107	-189	*77.0%*
After tax profit	**672**	**988**	*47.1%*
MI	-1	-2	*106.4%*
Net profit	**671**	**986**	***47.0%***
D&A	124	138	*10.9%*
EBITDA	**864**	**1,245**	***44.2%***

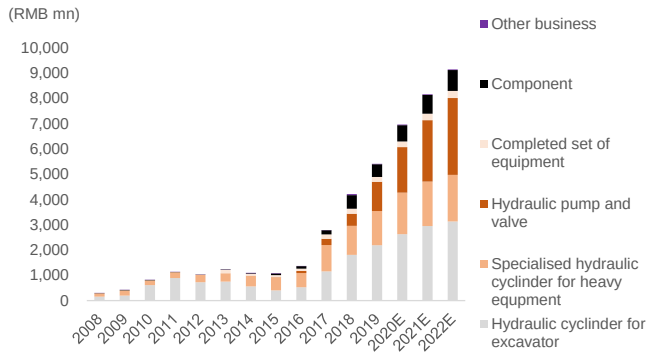
Source: Company data, CMBIS estimates

Figure 3: Change in key assumptions

	Old			New			Change		
(RMB mn)	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Revenue									
Hydraulic cyclinder for excavator	2,716	2,987	3,137	2,623	2,951	3,128	*-3.4%*	*-1.2%*	*-0.3%*
Specialised hydraulic cyclinder for heavy equpment	1,764	1,993	2,093	1,650	1,760	1,848	*-6.4%*	*-11.7%*	*-11.7%*
Hydraulic pump and valve	1,684	2,442	3,174	1,800	2,430	3,038	*6.9%*	*-0.5%*	*-4.3%*
Completed set of equipment	217	250	280	217	250	280	*0.0%*	*0.0%*	*0.0%*
Component	651	749	824	651	749	824	*0.0%*	*0.0%*	*0.0%*
Revenue (hydraulic business)	**7,032**	**8,421**	9,507	**6,942**	**8,140**	**9,117**	***-1.3%***	***-3.3%***	***-4.1%***
Other business	26	29	32	22	24	27	*-13.0%*	*-16.8%*	*-16.8%*
Total revenue	**7,058**	**8,450**	9,540	**6,964**	**8,164**	**9,144**	***-1.3%***	***-3.4%***	***-4.1%***
Gross margin									
Hydraulic cyclinder for excavator	*42.0%*	*42.0%*	*42.0%*	*44.0%*	*44.0%*	*44.0%*	*2.0*	*2.0*	*2.0*
Specialised hydraulic cyclinder for heavy equpment	*38.0%*	*38.0%*	*38.0%*	*40.0%*	*40.0%*	*40.0%*	*2.0*	*2.0*	*2.0*
Hydraulic pump and valve	*38.0%*	*40.0%*	*40.0%*	*41.0%*	*42.0%*	*42.0%*	*3.0*	*2.0*	*2.0*
Completed set of equipment	*29.0%*	*29.0%*	*29.0%*	*33.0%*	*33.0%*	*33.0%*	*4.0*	*4.0*	*4.0*
Component	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*30.0%*	*0.0*	*0.0*	*0.0*
Gross margin (hydraulic business)	***38.5%***	***39.0%***	***39.0%***	***40.6%***	***40.9%***	***40.9%***	*2.1*	*1.9*	*1.9*
Other business	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*66.0%*	*0.0*	*0.0*	*0.0*
Average gross margin	***38.6%***	***39.1%***	***39.1%***	***40.7%***	***41.0%***	***41.0%***	*2.1*	*1.9*	*1.9*
Net profit	**1,816**	**2,252**	**2,610**	**1,963**	**2,380**	**2,743**	***8.1%***	***5.7%***	***5.1%***

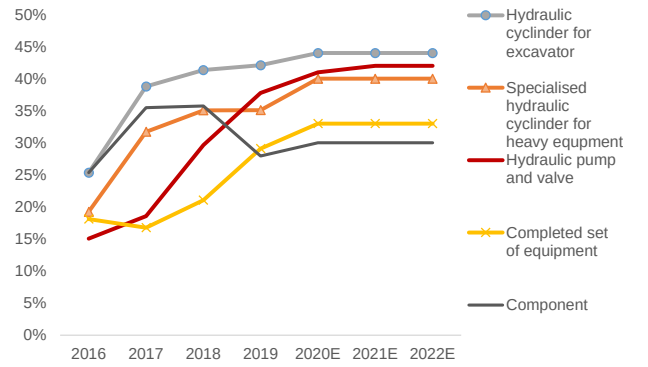
Source: Company data, CMBIS estimates

Figure 4: Hengli's revenue breakdown



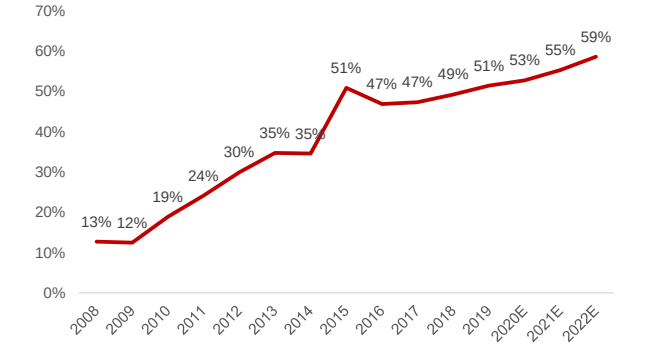
Source: Company data, CMBIS estimates

Figure 5: Gross margin for segment



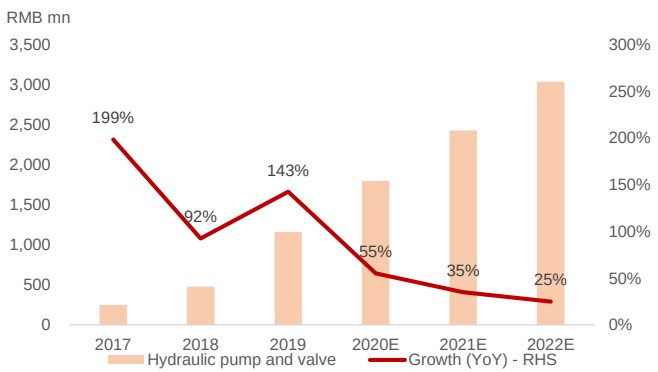
Source: Company data, CMBIS estimates

Figure 6: Hengli's market share in hydraulic cylinder for excavator



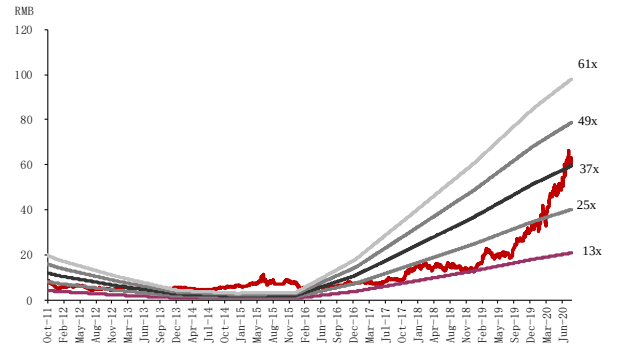
Source: Company data, CCMA, CMBIS estimates

Figure 7: Hengli's revenue of pump & valves



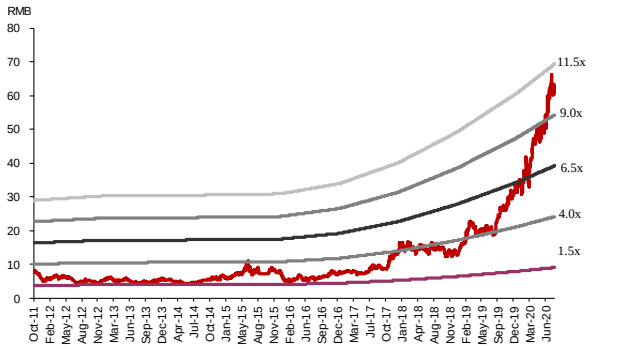
Source: Company reports, CMBIS

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**	**6,964**	**8,164**	**9,144**
Cost of sales	(2,671)	(3,369)	(4,130)	(4,818)	(5,396)
Gross profit	**1,540**	**2,045**	**2,834**	**3,346**	**3,749**
Surcharge	(43)	(52)	(70)	(82)	(91)
S&D expenses	(115)	(111)	(139)	(163)	(183)
Administrative expenses	(385)	(435)	(522)	(588)	(640)
Asset impairment	(119)	(52)	0	0	0
EBIT	**879**	**1,395**	**2,103**	**2,514**	**2,834**
Net finance income/(cost)	30	31	156	227	329
Finance income	168	187	208	272	369
Finance expenses	(138)	(156)	(52)	(44)	(41)
Other gains/(losses)	54	67	84	98	110
Profit of JV and associates	0	0	0	0	0
Pretax profit	**963**	**1,493**	**2,342**	**2,839**	**3,272**
Income tax	(126)	(195)	(375)	(454)	(524)
After tax profit	**837**	**1,298**	**1,967**	**2,385**	**2,749**
MI	(0)	(2)	(4)	(5)	(5)
Net profit	**837**	**1,296**	**1,963**	**2,380**	**2,743**
D&A	232	264	293	317	341
EBITDA	**1,110**	**1,659**	**2,395**	**2,830**	**3,175**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	963	1,493	2,342	2,839	3,272
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)	(375)	(454)	(524)
Change in working capital	(345)	66	(570)	(250)	(410)
Others	332	253	0	0	0
Cash flow from operation	**799**	**1,660**	**1,742**	**2,496**	**2,721**
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)	(785)	(952)
Interest paid	(3)	(107)	(52)	(44)	(41)
Others	(1)	18	0	0	0
Cash flow from financing	**(152)**	**(454)**	**(731)**	**(980)**	**(993)**
Change in cash	366	754	501	1,106	1,328
Cash at beginning of the year	1,146	1,571	2,343	2,844	3,951
Exchange and others	59	18	(0)	(0)	(0)
Cash at the end of the year	1,571	2,343	2,844	3,951	5,279

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**	**6,836**	**8,228**	**10,189**
Inventories	1,050	997	1,492	1,412	1,840
Trade and bill receivables	1,328	1,639	1,987	2,353	2,558
Prepayment	135	98	98	98	98
Others	358	414	414	414	414
Pledged deposits	0	0	0	0	0
Cash	1,571	2,343	2,844	3,951	5,279
Current liabilities	**1,981**	**2,170**	**2,343**	**2,279**	**2,503**
Trade and bill payables	691	791	1,064	1,100	1,324
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**	**7,052**	**8,652**	**10,449**
Shareholders' equity	4,547	5,584	7,018	8,613	10,404
MI	28	30	34	39	45

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Cylinder for excavator	43%	40%	38%	36%	34%
Cylinder for heavy equipment	27%	25%	24%	22%	20%
Hydraulic pump and valve	11%	21%	26%	30%	33%
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	40.7	41.0	41.0
EBIT margin	20.9	25.8	30.2	30.8	31.0
Net profit margin	19.9	24.0	28.2	29.2	30.1
Growth (%)					
Revenue	50.6	28.6	28.6	17.2	12.0
Gross profit	67.9	32.7	38.6	18.1	12.0
EBIT	90.9	58.7	50.8	19.5	12.8
Net profit	119.1	54.9	51.5	21.2	15.3
Balance sheet ratio					
Current ratio (x)	2.2	2.5	2.9	3.6	4.1
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 cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	12.5	16.5	21.3	22.2	22.0
ROE	19.9	25.6	31.2	30.5	28.9
Per share data					
EPS (RMB)	0.64	0.99	1.50	1.82	2.10
BVPS (RMB)	3.48	4.28	5.38	6.60	7.97
DPS (RMB)	0.20	0.41	0.60	0.73	0.84

Source: Company data, CMBIS estimates

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