Zoomlion Heavy Industry - A (000157 CH)

2Q20 profit a strong beat; Lift earnings est. & TP

Zoomlion released a positive profit alert yesterday, stating that net profit in 1H20E will reach RMB3.8-4.2bn, representing 47-63% YoY growth. This is a surprise as the earnings range implies 75-100% YoY growth in 2Q20E. We raise our 2020E-22E earnings forecast significantly by 24-42% (14-27% above consensus), and lift our TP to RMB9.56. We see Zoomlion entering into a new growth trajectory, driven by the solid upcycle of concrete machinery and tower crane, as well as the aggressive expansion into attractive sub-segments such as excavator, aerial working platform (AWP) and hydraulic components. Near term catalysts include earnings revision by the market and strong machinery demand in 3Q. Reiterate **BUY.**

- **New assumptions.** The strong earnings growth in 1H20 was driven by strong demand for concrete pump truck, tower crane and construction crane, as well as the lower expense ratio thanks to the operating leverage and stringent cost control. We revise up our revenue and margin forecast in 2020E-22E. Our new forecast includes the potential dilution effect arising from the share placement and the new capacity expansion plan released by the Company last week.
- **Attractive valuation (9.8x 20E P/E) suggests significant upside potential.** We switch our valuation methodology from asset-based to earnings-based approach, in order to better capture the robust earnings growth outlook. Our new TP of RMB9.56 is based on 12x 2020E P/E (previously RMB6.85 based on 1.2x 2020E P/B). In 2011, the year when Zoomlion's earnings reach a historical high of RMB8.3bn, the stock traded at a valuation range of 10-12x despite the high earnings base. We benchmark our target multiple (12x) to such valuation. We believe our target is not aggressive, given our EPS growth estimate of 37%/18% in 2020E/21E.
- **Risk factors:** (1) Unexpected weakness on infrastructure spending; (2) Slow recovery of property construction; (3) Risks of new business expansion.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	28,697	43,307	59,158	70,670	80,062
YoY growth (%)	39.3	50.9	36.6	19.5	13.3
Net income (RMB mn)	2,031	4,381	6,777	8,566	9,848
EPS (RMB)	0.27	0.58	0.80	0.94	1.08
YoY growth (%)	51.5	119.2	36.7	17.7	15.0
Consensus EPS (RMB)	n/a	n/a	0.70	0.79	0.85
EV/EBITDA (x)	16.5	10.8	8.0	6.6	5.8
P/E (x)	27.9	13.1	9.8	8.3	7.1
P/B (x)	1.5	1.5	1.3	1.2	1.1
Yield (%)	3.4	0.0	4.1	4.8	5.7
ROE (%)	5.4	11.4	14.7	15.3	15.8
Net gearing (%)	33.6	31.3	2.5	1.0	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	**RMB9.56**
(Previous TP	RMB6.85)
Up/Downside	**+22%**
Current Price	**RMB$7.82**

China Capital Goods

Wayne Fung, CFA
(852) 3900 0826
waynefung@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	60,315
Avg 3 mths t/o (RMB mn)	419
52w High/Low (RMB)	8.10/5.21
Total Issued Shares (mn)	**6,456 (A)**
	1,388 (H)

Source: Bloomberg

Shareholding Structure

SASAC of Hunan Province	16.0%
Management team	4.9%
A share free float	61.4%
H share free float	17.7%

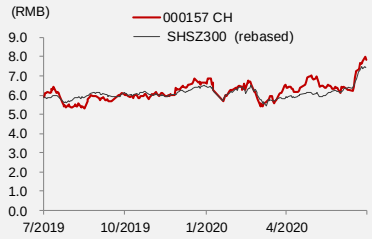
Source: HKEx, Shanghai Stock Exchange

Share Performance

	Absolute	Relative
1-mth	28.3%	5.8%
3-mth	23.4%	-4.6%
6-mth	20.6%	4.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

1. China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020
2. Zoomlion (000157 CH, BUY) – Dividend cut a surprise; Positive on the recovery story – 31 Mar 2020

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Figure 1: Change in key assumptions

	Old			New			Change		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
(RMB mn)									
Revenue									
Construction machinery	46,501	51,124	55,139	56,573	67,827	76,982	22%	33%	40%
Concrete machinery	15,570	16,816	17,825	18,768	21,583	23,741	21%	28%	33%
Crane machinery	25,248	27,772	29,994	29,898	34,383	37,822	18%	24%	26%
Others	5,683	6,536	7,320	7,907	11,861	15,419	39%	81%	111%
Agricultural machinery	1,583	1,615	1,695	1,741	1,915	2,107	10%	19%	24%
Financial services	806	847	889	843	927	974	5%	10%	10%
Total revenue	**48,890**	**53,585**	**57,723**	**59,158**	**70,670**	**80,062**	**21%**	**32%**	**39%**
Revenue growth							***Change in ppt***		
Construction machinery	*13.4%*	*9.9%*	*7.9%*	*38.0%*	*19.9%*	*13.5%*	*24.6*	*10.0*	*5.6*
Concrete machinery	*12.0%*	*8.0%*	*6.0%*	*35.0%*	*15.0%*	*10.0%*	*23.0*	*7.0*	*4.0*
Crane machinery	*14.0%*	*10.0%*	*8.0%*	*35.0%*	*15.0%*	*10.0%*	*21.0*	*5.0*	*2.0*
Others	*15.0%*	*15.0%*	*12.0%*	*60.0%*	*50.0%*	*30.0%*	*45.0*	*35.0*	*18.0*
Agricultural machinery	*0.0%*	*2.0%*	*5.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0*	*8.0*	*5.0*
Financial services	*10.0%*	*5.0%*	*5.0%*	*15.0%*	*10.0%*	*5.0%*	*5.0*	*5.0*	*0.0*
Total revenue growth	***12.9%***	***9.6%***	***7.7%***	***36.6%***	***19.5%***	***13.3%***	***23.7***	***9.9***	***5.6***
Gross margin							***Change in ppt***		
Construction machinery	*29.6%*	*29.5%*	*29.5%*	*30.3%*	*30.2%*	*30.2%*	*0.66*	*0.65*	*0.68*
Concrete machinery	*27.3%*	*27.2%*	*27.2%*	*29.0%*	*29.0%*	*29.0%*	*1.70*	*1.80*	*1.80*
Crane machinery	*32.6%*	*32.5%*	*32.5%*	*33.0%*	*33.0%*	*33.0%*	*0.40*	*0.50*	*0.50*
Others	*22.7%*	*22.7%*	*22.7%*	*23.0%*	*24.0%*	*25.0%*	*0.30*	*1.30*	*2.30*
Agricultural machinery	*4.3%*	*4.3%*	*4.3%*	*6.0%*	*8.0%*	*10.0%*	*1.70*	*3.70*	*5.70*
Financial services	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*0.00*	*0.00*	*0.00*
Average gross margin	***30.0%***	***29.9%***	***29.8%***	***30.6%***	***30.5%***	***30.5%***	***0.60***	***0.61***	***0.65***

Source: Company data, CMBIS estimates

Share placement plan a positive

Last week, Zoomlion announced a non-public share placement plan. Zoomlion will issue a maximum of 1.25bn new shares (A-share) to four strategic investors, raising up to RMB6.6bn.

Details:

- The four strategic investors are Huaijin Cornerstone, Taiping Life Insurance, Hainan Chengyisheng and Ningbo Shituo. The lock-up period is 18 months.
- The new shares will account for 15.8% of the existing o/s shares. The issue price is RMB5.28.
- The capital will be spent on four areas: (1) intelligent manufacturing project for excavators; (2) capacity upgrade on concrete mixers; (3) key components intelligent manufacturing project; (4) intelligent manufacturing project of key hydraulic parts (hydraulic valves).
- The share placement plan is subject to the approval of shareholders and CSRC.

Analysis:

The share placement plan will help remove the overhang as market had expected a fund-raising exercise. We see several positives in the share placement plan:

- First, the strategic investors have strong background. In particular, Hainan Chengyisheng is held as to 24.48%, 6.49% and 6.49% by Zhan Chunxin (executive Director of Zoomlion), Qin Xiuhong (senior manager) and Yang Duzhi (senior manager), respectively, each as a limited partner. The subscription of shares by senior management should enhance market confidence.
- Second, the lock-up period of 18 months is long, which should not exert pressure on the share price in the foreseeable future.
- Third, the new business areas are attractive with good potential of import substitution, offering new growth drivers to Zoomlion. Zoomlion estimates that the IRR of the four projects will range from 22% to 28%.

Figure 2: Strategic shareholders

Subscriber	Background of subscribers	Subscription amount (RMB mn)	Shares to be subscribed mn	% of total
Huaijin Cornerstone	Investment fund (AUM: RMB50bn)	3,100	587.1	47.0%
Taiping Life Insurance	Leading life insurer in China	1,900	359.8	28.8%
Hainan Chengyisheng	Limited partnership established by Zoomlion's senior management	1,000	189.4	15.2%
Ningbo Shituo	PE fund owned by China Minmetals	600	113.6	9.1%
Total		6,600	1,250.0	100.0%

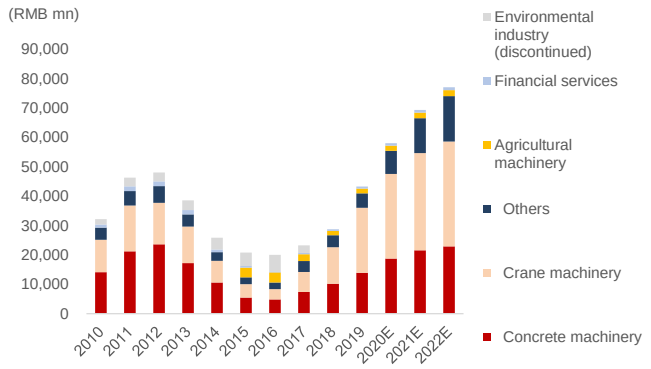
Source: Company data, CMBIS

Figure 3: Use of proceeds from share placement

Project	Project investment amount RMB mn	Funding from new share issuance RMB mn	Estimated IRR
Excavator intelligent manufacturing project	3,083	2,400	28.0%
Upgrade of intelligent manufacturing of mixers	830	350	22.5%
Key components intelligent manufacturing project	1,668	1,300	24.9%
Intelligent manufacturing project of key hydraulic parts	443	250	23.6%
Working capital	2,300	2,300	-
Total	8,323	6,600	-

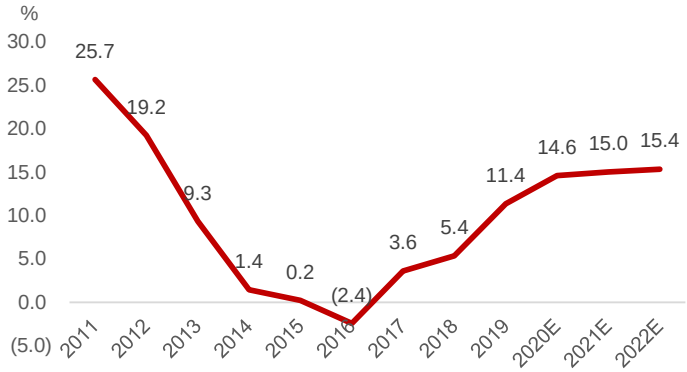
Source: Company estimates, CMBIS

Figure 4: Zoomlion's revenue trend



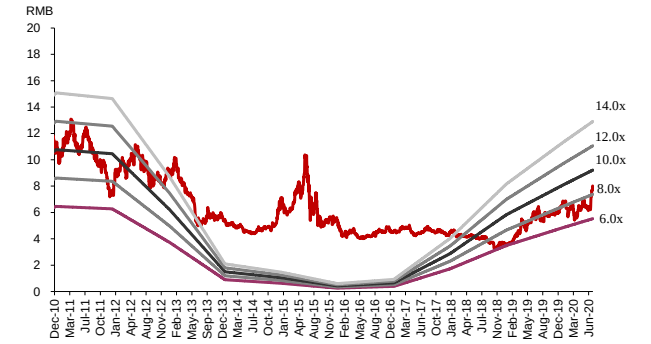
Source: Company data, CMBIS estimates

Figure 5: Zoomlion's ROE trend



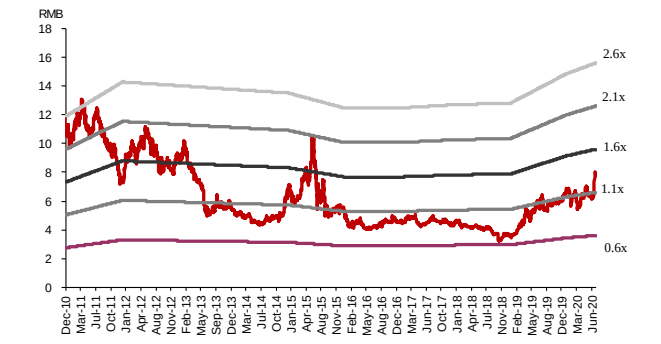
Source: Company data, CMBIS estimates

Figure 6: Zoomlion - A 12M forward P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 7: Zoomlion – A 12M forward 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	**28,697**	**43,307**	**59,158**	**70,670**	**80,062**
Cost of sales	-20,923	-30,314	-41,082	-49,137	-55,657
Gross profit	**7,774**	**12,993**	**18,075**	**21,533**	**24,405**
Other income	882	1,017	400	430	440
S&D expenses	-2,379	-3,780	-4,733	-5,442	-6,165
Administrative expenses	-2,063	-2,693	-3,609	-4,099	-4,483
R&D expenses	-581	-1,516	-1,893	-2,332	-2,642
EBIT	**3,633**	**6,021**	**8,241**	**10,090**	**11,555**
Net finance income/(cost)	-1,205	-1,165	-313	-18	47
Finance income	347	539	782	1,053	1,012
Finance expenses	-1,552	-1,704	-1,094	-1,071	-964
Other gains/(losses)	0	0	0	0	0
Profit of JV and associates	222	188	254	271	288
Pretax profit	**2,650**	**5,044**	**8,183**	**10,343**	**11,891**
Income tax	-682	-759	-1,473	-1,862	-2,140
After tax profit	**1,968**	**4,285**	**6,710**	**8,481**	**9,751**
MI/discontinued operation	63	96	67	85	98
Net profit	**2,031**	**4,381**	**6,777**	**8,566**	**9,848**
D&A	837	817	923	1,005	1,080
EBITDA	**4,470**	**6,838**	**9,164**	**11,096**	**12,635**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	2,650	5,044	8,183	10,343	11,891
Finance cost	1,451	1,704	1,094	1,071	964
Interest income	-347	-539	-782	-1,053	-1,012
Profit or loss of associates	-222	-188	-254	-271	-288
Disposal of PP&E/business	-152	0	0	0	0
Depreciation and amortization	837	817	923	1,005	1,080
Income tax paid	-431	-773	-1,473	-1,862	-2,140
Change in working capital	1,152	442	-1,702	-2,940	-2,994
Others	-221	-539	0	0	0
Cash flow from operation	**4,717**	**5,968**	**5,989**	**6,294**	**7,501**
Net capex on PP&E	-272	-1,082	-2,246	-2,646	-2,500
Investment in JV/associates	-4	-301	0	0	0
Investment in subsidiaries	0	-177	0	0	0
Investment in intangible assets	-103	-128	-100	0	0
Dividend received	4	45	0	0	0
Interest received	347	253	782	1,053	1,012
Others	-7,214	11,374	0	0	0
Cash flow from investing	**-7,242**	**9,984**	**-1,564**	**-1,593**	**-1,488**
Equity financing/(repurchase)	37	-2,145	7,674	0	0
Net bank borrowings	6,817	-14,008	-1,000	100	-4,100
Dividend paid	-1,308	-1,801	0	-2,894	-3,426
Interest paid	-1,428	-1,707	-1,094	-1,071	-964
Others	-16	13	0	0	0
Cash flow from financing	**4,102**	**-19,648**	**5,579**	**-3,864**	**-8,491**
Change in cash	1,577	-3,696	10,004	836	-2,478
Cash at beginning of the year	7,148	8,754	5,073	15,077	15,913
Exchange and others	29	15	0	0	0
Cash at the end of the year	8,754	5,073	15,077	15,913	13,436

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	**28,657**	**37,979**	**41,303**	**46,120**	**49,785**
PP&E	6,077	6,735	8,324	10,234	11,922
Lease prepayment	1,943	2,433	2,383	2,333	2,283
JV/associates	3,500	3,909	4,163	4,434	4,723
Finance lease receivables	3,656	7,771	7,788	10,024	9,717
Goodwill	2,046	2,017	2,017	2,017	2,017
Trade receivables	5,498	9,072	10,701	11,371	13,635
Intangible assets	2,153	2,043	1,927	1,708	1,489
Financial assets	2,379	2,644	2,644	2,644	2,644
Others	0	0	0	0	0
Deferred tax assets	1,276	1,271	1,271	1,271	1,271
Deposits	129	84	84	84	84
Current assets	**64,762**	**54,052**	**74,128**	**76,252**	**83,381**
Inventories	9,551	11,772	11,639	14,477	15,105
Trade & other receivables	21,554	20,839	25,515	26,374	30,656
Finance lease receivables	8,835	9,229	14,758	12,348	17,045
Financial assets at FVPL	13,787	4,311	4,311	4,311	4,311
Others	1,097	1,413	1,413	1,413	1,413
Pledged deposits	1,184	1,415	1,415	1,415	1,415
Cash	8,754	5,073	15,077	15,913	13,436
Current liabilities	**39,623**	**34,569**	**44,386**	**45,739**	**54,409**
Trade and other payables	15,786	25,012	34,642	35,361	43,931
Bank borrowings	22,044	7,312	7,112	7,212	7,312
Tax payable	151	186	186	186	186
Contract liabilities	1,602	1,934	2,321	2,855	2,855
Others	40	125	125	125	125
Non-current liabilities	**15,065**	**17,965**	**17,165**	**17,165**	**12,965**
Bank borrowings	13,645	14,515	13,715	13,715	9,515
Deferred tax liabilities	429	455	455	455	455
Others	991	2,995	2,995	2,995	2,995
Equity	**38,731**	**39,497**	**53,881**	**59,468**	**65,792**
Shareholders' equity	38,164	38,827	53,278	58,950	65,372
MI	567	670	603	518	421

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Concrete machinery	35%	32%	32%	31%	30%
Crane machinery	43%	51%	51%	49%	47%
Others machinery	14%	11%	13%	17%	19%
Agricultural machinery	5%	4%	3%	3%	3%
Financial services	2%	2%	1%	1%	1%
Environmental (discontinued)	0%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
Profit & loss ratio (%)					
Gross margin	27.1	30.0	30.6	30.5	30.5
EBIT margin	12.7	13.9	13.9	14.3	14.4
Net profit margin	6.9	9.9	11.3	12.0	12.2
Growth (%)					
Revenue	39.3	50.9	36.6	19.5	13.3
Gross profit	80.6	67.1	39.1	19.1	13.3
EBIT	n/a	65.7	36.9	22.4	14.5
Net profit	51.3	115.7	54.7	26.4	15.0
Balance sheet ratio					
Current ratio (x)	1.6	1.6	1.7	1.7	1.5
Trade receivable turnover days	342	240	204	191	187
Finance lease receivable turnover days	161	124	122	116	112
Inventory turnover days	161	128	104	97	97
Payable turnover days	268	246	265	260	260
Net debt / total equity (%)	33.6	31.3	2.5	1.0	Net cash
Profitability (%)					
ROA	2.3	4.7	6.5	7.2	7.7
ROE	5.4	11.4	14.7	15.3	15.8
Per share data					
EPS (RMB)	0.27	0.58	0.80	0.94	1.08
BVPS (RMB)	4.89	4.93	5.84	6.46	7.16
DPS (RMB)	0.25	0.00	0.32	0.38	0.43

Source: Company data, CMBIS estimates

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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