

Zoomlion Heavy Industry - A (000157 CH)

Stock ownership plan to offer strong incentive to management

What's new? We believe the stock ownership plan that announced last Friday will offer strong motivation to the management and key employees to deliver sustainable earnings growth over the next three years, which should more than offset the share incentive expense arising from this. We maintain our TP of RMB7.28 (based on 1.4x 2019E P/B, on the back of 12%-13% ROE in 2019E-21E). Reiterate **BUY**.

■ **Details of the stock ownership plan.** The participants include the core management and key employees in the Company, with a maximum of 1,200 employees. The purchase price is set at RMB2.75 per share. The lock-up period is divided into three stages, with 40%, 30% and 30% of the shares to be unlocked in 2020E, 2021E and 2022E respectively, subject to Zoomlion's net profit targets during the period. Either of the following two criteria has to be satisfied for each of the year: (1) In 2020/ 21/ 22, the net profit growth to be no less than 80%/90%/100%, compared with the Benchmark (Benchmark = average net profit in 2017-19); (2) the total net profit in 2020-21 to grow 170% from the Benchmark, and the total net profit in 2020-22 to grow 270% from the Benchmark (Figure 1). The stock ownership plan is subject to the approval by shareholders in EGM.

■ **Higher expense but higher employee incentive.** Given that the underlying shares of the stock ownership plan are the 390mn A shares (4.96% of total o/s shares) the Company repurchased in 2Q19 (average price: RMB5.49), we calculate that the total share incentive expense to Zoomlion to be RMB1bn in 2020E-22E. That's said, we believe the discount on purchase price (RMB2.75) is attractive to the participants, offering strong incentive.

■ **Investment in agricultural machinery segment.** Zoomlion plans to invest RMB2.05bn in 2020-25 (annual capex: RMB342mn) in the intelligent agriculture machinery business in Wuhu. While the industry has been on a downcycle, Zoomlion expects the favourable government policy to support the upgrade of agriculture machinery will offer new opportunities. In 2018/1H19, revenue from agricultural machinery accounted for only 5%/4% of the total revenue. Zoomlion targets to achieve breakeven this year versus a loss in 2018. We fine-tuned our 2020E-21E earnings forecast by -0.5%/-0.5% after incorporating the capex but have not modelled growth in this segment. Any improvement will offer upside to our existing forecast.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	20,608	28,697	44,342	50,749	54,824
YoY growth (%)	2.9	39.3	54.5	14.4	8.0
Net income (RMB mn)	1,342	2,031	4,551	5,321	5,719
EPS (RMB)	0.18	0.27	0.58	0.68	0.73
YoY growth (%)	n/a	51.5	118.6	16.6	7.5
EV/EBITDA (x)	n/a	13.5	7.5	6.7	6.4
P/E (x)	31.8	21.7	10.2	8.8	8.1
P/B (x)	1.2	1.2	1.2	1.1	1.0
Yield (%)	3.6	4.3	5.9	6.9	7.4
ROE (%)	3.6	5.4	11.9	13.2	13.1
Net gearing (%)	39.6	33.6	33.2	23.0	15.0

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	RMB7.28
(Previous TP	RMB7.28)
Up/Downside	+22%
Current Price	RMB5.99

China Capital Goods

Wayne Fung, CFA

(852) 3900 0826

waynefung@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	46,573
Avg 3 mths t/o (RMB mn)	221
52w High/Low (RMB)	6.47/3.45
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%

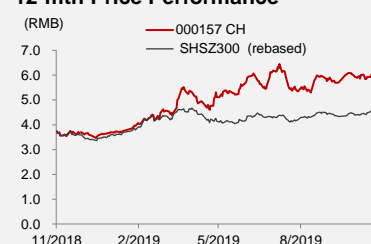
Source: HKEx, Shanghai Stock Exchange

Share Performance

	Absolute	Relative
1-mth	+0.2%	+1.4%
3-mth	+12.0%	+7.2%
6-mth	+17.0%	+10.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

1. Zoomlion (000157 CH, BUY) – Raising earnings estimates on surprising strong 3Q19 profit – 15 Oct 2019
2. Zoomlion (000157 CH, BUY) - Net profit +196% YoY in 1H19 within expectations – 2 Sep 2019
3. Zoomlion (000157 CH, BUY) – 2Q19 Earnings above expectations; Initiate with BUY – 15 Jul 2019

Figure 1: Stock incentive plan and estimated expense

	2017	2018	2019E	2020E	2021E	2022E
(RMB mn)						
Net profit (CMBI estimates)	1,342	2,031	4,551	5,321	5,719	-
Average net profit in 2017-19E (Benchmark for the calculation of performance)			2,641			

Performance target (either A or B)

	2020E	2021E	2022E
(A)			
Net profit growth compared with the Benchmark	80%	90%	100%
Net profit target (RMB mn)	4,755	5,019	5,283
(B)			
Accumulated net profit growth compared with the Benchmark	-	170%	270%
Accumulated net profit target (RMB mn)	-	7,132	9,773

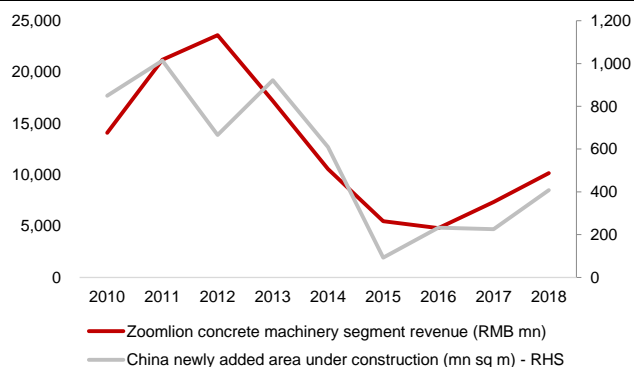
Unlock period

	1st	2nd	3rd
% of total shares to be unlocked under the stock ownership plan	40%	30%	30%

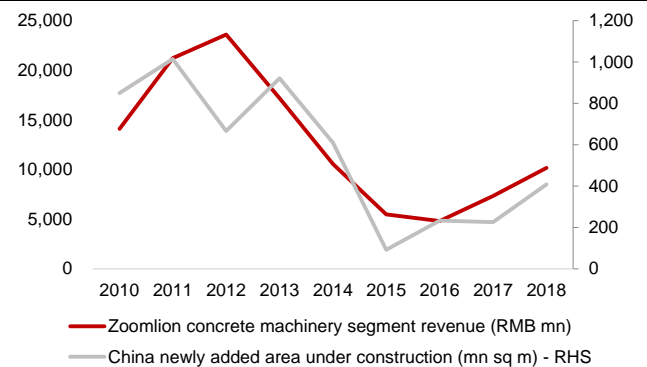
Calculation of the share incentive expense

Number of A-shares repurchased for the stock ownership plan (mn)	390
Repurchased price (RMB per share)	5.49
Exercise price of the stock ownership plan (RMB per share)	2.75
Total amount spent on repurchase (RMB mn)	2,144
Maximum fund raised from the stock ownership plan (RMB mn)	1,074
Total share incentive expense in 2020E-22E (RMB mn)	1,070

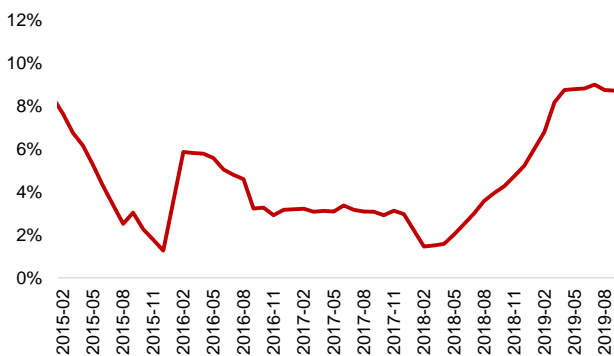
Source: Company data, CMBIS estimates

Figure 2: China tower crane sales vs China newly added property area under construction

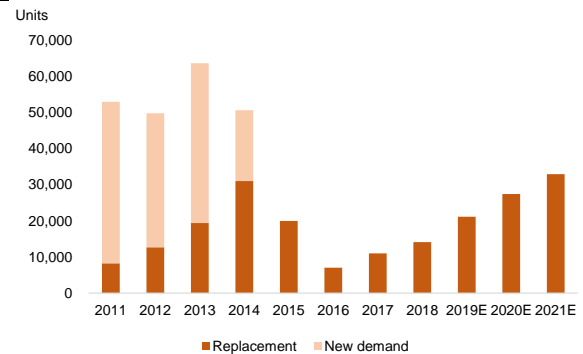
Source: NBS, CCMA, Wind, CMBIS

Figure 3: Zoomlion concrete machinery sales vs China newly added area under construction

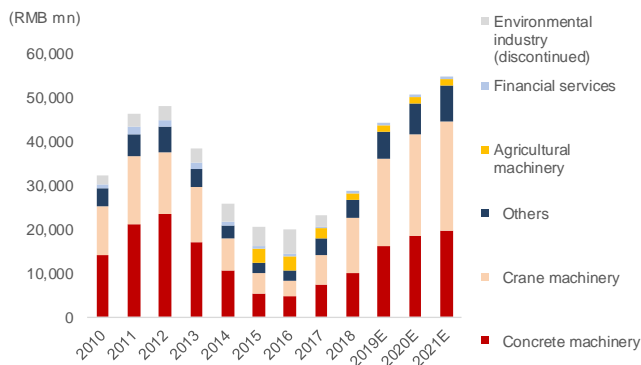
Source: NBS, Wind, Company data, CMBIS

Figure 4: China monthly property area under construction growth (YoY)

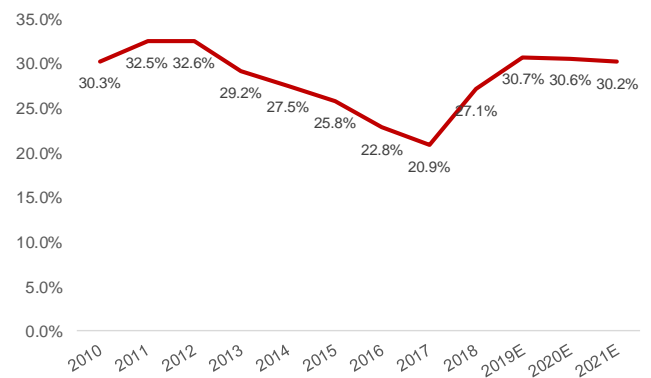
Source: NBS, Wind, CMBIS

Figure 5: CMBI forecast on China tower crane sales volume

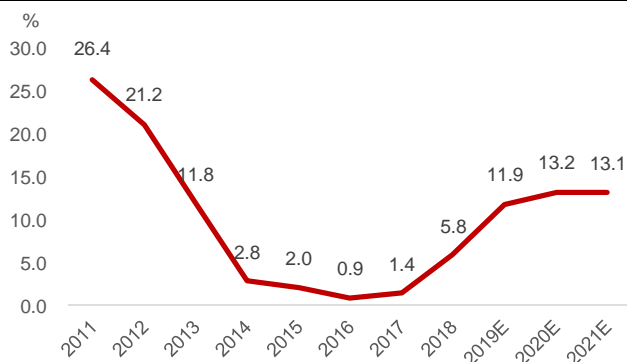
Source: CCMA, CMBIS estimates

Figure 6: Zoomlion's revenue trend

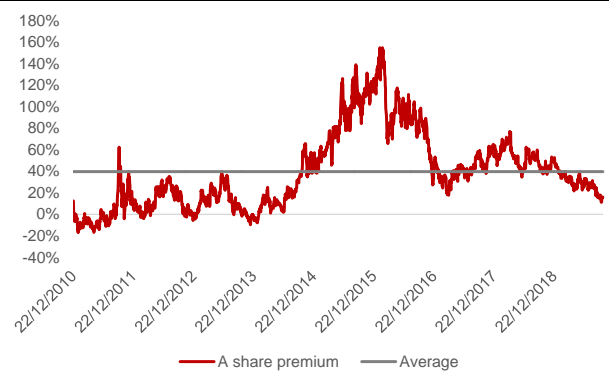
Source: Company data, CMBIS estimates

Figure 7: Zoomlion's gross margin trend

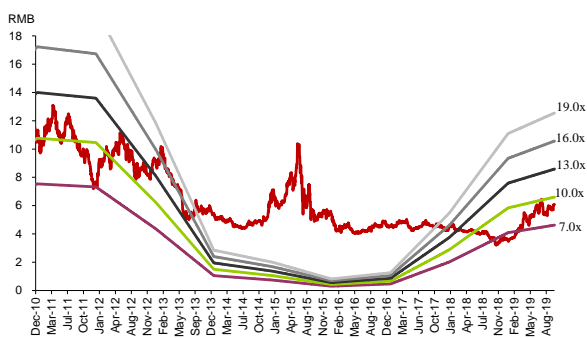
Source: Company data, CMBIS estimates

Figure 8: Zoomlion's ROE trend

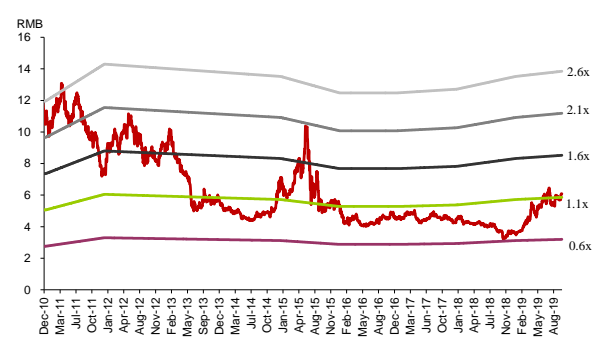
Source: Company data, CMBIS estimates

Figure 9: Zoomlion A share premium to H share

Source: Bloomberg, CMBIS

Figure 10: Zoomlion - A 12M forward P/E band

Source: Bloomberg, Company data, CMBIS estimates

Figure 11: Zoomlion - A 12M forward P/B band

Source: Bloomberg, Company data, CMBIS estimates

Key catalysts: Rising infrastructure spending, resilient growth of property area under construction, replacement of national emission standard (NES) III trucks, and market share gain on tower crane and concrete machinery will all serve as share price catalysts.

Risk factors: (1) Unexpected weakness on property construction activities; (2) Slow recovery of infrastructure spending; (3) High earnings volatility.

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total revenue	20,608	28,697	44,342	50,749	54,824
Cost of sales	-16,303	-20,923	-30,741	-35,229	-38,280
Gross profit	4,305	7,774	13,602	15,520	16,544
Other income	259	882	682	732	772
S&D expenses	-2,180	-2,379	-3,326	-3,806	-4,112
Administrative expenses	-10,487	-2,063	-2,882	-3,299	-3,564
R&D expenses	-277	-581	-887	-1,015	-1,096
EBIT	-8,380	3,633	7,189	8,132	8,544
Net finance income/(cost)	-1,443	-1,205	-1,359	-1,285	-1,182
Finance income	366	347	385	397	477
Finance expenses	-1,809	-1,552	-1,745	-1,682	-1,658
Other gains/(losses)	0	0	0	0	0
Profit of JV and associates	110	222	235	243	259
Pretax profit	-9,713	2,650	6,065	7,090	7,621
Income tax	1,425	-682	-1,559	-1,822	-1,959
After tax profit	-8,288	1,968	4,506	5,268	5,662
MI/discontinued operation	9,630	63	45	53	57
Net profit	1,342	2,031	4,551	5,321	5,719
Recurring net profit	508	2,199	4,551	5,321	5,719
D&A	924	837	852	879	911
EBITDA	-7,456	4,470	8,041	9,012	9,454

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Pretax profit	1,252	2,650	6,065	7,090	7,621
Finance cost	1,488	1,451	1,745	1,682	1,658
Interest income	-398	-347	-385	-397	-477
Profit or loss of associates	-90	-222	-235	-243	-259
Disposal of PP&E/business	-10,763	-152	0	0	0
Depreciation and amortization	968	837	852	879	911
Income tax paid	-227	-431	-1,559	-1,822	-1,959
Change in working capital	10,037	1,152	-218	68	873
Others	186	-221	0	0	0
Cash flow from operation	2,453	4,717	6,264	7,257	8,369
Net capex on PP&E	-73	-272	-700	-1,046	-946
Investment in JV/associates	-8	-4	0	0	0
Investment in subsidiaries	10,428	0	0	0	0
Investment in intangible assets	-156	-103	-100	-100	0
Dividend received	5	4	0	0	0
Interest received	398	347	385	397	477
Others	-6,558	-7,214	0	0	0
Cash flow from investing	4,036	-7,242	-415	-749	-469
Equity financing/(repurchase)	216	37	-2,145	1,074	0
Net bank borrowings	-3,442	6,817	-1,400	-1,000	100
Dividend paid	-1,141	-1,308	-1,952	-2,731	-3,193
Interest paid	-1,527	-1,428	-1,745	-1,682	-1,658
Others	-12	-16	0	0	0
Cash flow from financing	-5,906	4,102	-7,242	-4,339	-4,751
Change in cash	583	1,577	-1,392	2,169	3,149
Cash at beginning of the year	6,575	7,148	8,754	7,362	9,531
Exchange and others	-10	29	0	0	0
Cash at the end of the year	7,148	8,754	7,362	9,531	12,679

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	25,218	28,657	28,512	30,558	29,655
PP&E	6,274	6,077	6,185	6,618	6,923
Lease prepayment	1,935	1,943	1,893	1,843	1,793
JV/associates	3,123	3,500	3,735	3,978	4,237
Finance lease receivables	1,870	3,656	2,175	3,108	1,398
Goodwill	2,088	2,046	2,046	2,046	2,046
Trade receivables	4,106	5,498	6,651	7,253	7,767
Intangible assets	2,250	2,153	2,043	1,927	1,708
Financial assets	2,154	2,379	2,379	2,379	2,379
Others	0	0	0	0	0
Deferred tax assets	1,358	1,276	1,276	1,276	1,276
Deposits	60	129	129	129	129
Current assets	57,894	64,762	73,251	72,246	82,376
Inventories	8,886	9,551	12,178	10,600	12,473
Trade & other receivables	22,661	21,554	25,826	27,009	28,265
Finance lease receivables	10,931	8,835	11,818	9,038	12,891
Financial assets at FVPL	6,323	13,787	13,787	13,787	13,787
Others	897	1,097	1,097	1,097	1,097
Pledged deposits	1,048	1,184	1,184	1,184	1,184
Cash	7,148	8,754	7,362	9,531	12,679
Current liabilities	24,488	39,623	48,758	46,988	53,745
Trade and other payables	14,992	15,786	24,640	22,654	28,736
Bank borrowings	9,348	22,044	21,844	21,644	21,744
Tax payable	148	151	151	151	151
Contract liabilities	0	1,602	2,083	2,499	3,074
Others	0	40	40	40	40
Non-current liabilities	20,434	15,065	13,865	13,065	13,065
Bank borrowings	19,296	13,645	12,445	11,645	11,645
Deferred tax liabilities	485	429	429	429	429
Others	653	991	991	991	991
Equity	38,190	38,731	39,140	42,751	45,221
Shareholders' equity	37,540	38,164	38,618	42,282	44,809
MI	650	567	522	469	413

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Concrete machinery	32%	35%	37%	37%	36%
Crane machinery	29%	43%	45%	45%	45%
Others machinery	16%	14%	14%	14%	15%
Agricultural machinery	10%	5%	3%	3%	3%
Financial services	2%	2%	1%	1%	1%
Environmental (discontinued)	11%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
Profit & loss ratio (%)					
Gross margin	20.9	27.1	30.7	30.6	30.2
EBIT margin	(40.7)	12.7	16.2	16.0	15.6
Net profit margin	(40.2)	6.9	10.2	10.4	10.3
Growth (%)					
Revenue	2.9	39.3	54.5	14.4	8.0
Gross profit	(9.9)	80.6	75.0	14.1	6.6
EBIT	n/a	n/a	97.9	13.1	5.1
Core net profit	54.4	332.9	107.0	16.9	7.5
Balance sheet ratio					
Current ratio (x)	2.4	1.6	1.5	1.5	1.5
Trade receivable turnover days	548	342	245	240	234
Finance lease receivable turnover days	238	161	109	94	88
Inventory turnover days	242	161	129	118	110
Payable turnover days	359	268	240	245	245
Net debt / total equity (%)	39.6	33.6	33.2	23.0	15.0
Profitability (%)					
ROA	1.6	2.3	4.7	5.2	5.3
Core ROE	1.4	5.8	11.9	13.2	13.1
Per share data					
EPS (RMB)	0.18	0.27	0.58	0.68	0.73
Core EPS (RMB)	0.07	0.29	0.58	0.68	0.73
BVPS (RMB)	4.82	4.89	4.92	5.39	5.71
DPS (RMB)	0.20	0.25	0.35	0.41	0.44

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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