

Lonking (3339 HK)

Recovery of wheel loader sales; Proxy of metal prices; U/G to BUY

What's changed? While we believe wheel loader, Lonking's key product, will continue to be threatened by small-size excavators, we expect the impact will be less than what we expected as we see several near term positive factors: (1) strong wheel loader sales in Jan (+56% YoY) suggested strong demand from infrastructure and mining activities; (2) the recent strong non-ferrous metal prices will boost Lonking's valuation as Lonking's share price has historically been correlated with metal prices; (3) recent good performance of equity market will help boost the return of Lonking's investment products. We revised up Lonking's core net profit in 2020E-22E by 4-13%, after revising up the sales volume of all products, and raised our TP from HK\$2.22 (7x 2020E P/E) to HK\$4.01 (SOTP). Current price offers 8-9% dividend yield in 2020E-21E. **Upgrade to BUY** from Sell.

- **Surprising strong wheel loader sales in Jan.** According to CCMA, sales volume of wheel loader by major players grew 52% YoY to 8.9k units in Jan. The figure is stronger than our expectation even taking into consideration of the low base effect (early CNY in 2020). We believe the strong growth reflected the solid infrastructure construction and a potential recovery mining activities. Lonking, the largest player in wheel loader market with solid presence (22% market share in 1H20), is set to benefit from the strong demand.
- **A beneficiary of rising non-ferrous metal price.** We expect Lonking will benefit from the recent strong performance of non-ferrous metal price, as demand for wheel loader, with high exposure in mining segment, will likely be driven by the potential increase in spending on mining projects. Historically, Lonking's share price moved in tandem with the price of copper and aluminum (Figure 4 & 5).
- **Key catalysts:** (1) strong machinery sales data; (2) recovery of mining capex.
- **Downside risks:** (1) market share loss due to strong competitors in the excavator segment; (2) structural weakness in wheel loader demand; (3) investment loss.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	11,868	11,744	12,243	12,909	12,915
YoY growth (%)	32.0	-1.0	4.3	5.4	0.0
Net income* (RMB mn)	1,144	1,643	1,518	1,547	1,568
EPS (RMB)	0.267	0.384	0.355	0.361	0.366
YoY growth (%)	9.4	43.7	-7.6	1.9	1.4
Consensus (RMB)	n/a	n/a	0.34	0.33	0.33
EV / EBITDA (x)	5.4	3.9	4.2	4.1	4.2
P/E (x)	9.4	6.7	7.2	6.6	6.5
P/B (x)	1.3	1.2	1.1	1.0	0.9
Yield (%)	6.8	8.9	8.3	9.1	9.3
ROE (%)	14.4	19.0	16.2	15.6	14.8
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

*Reported net profit

Source: Company data, Bloomberg, CMBIS estimates

BUY (Up)

Target Price	HK\$4.01
(Previous TP)	HK\$2.22)
Up/Downside	41%
Current Price	HK\$2.85

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Stock Data

Mkt Cap (HK\$ mn)	12,198
Avg 3 mths t/o (HK\$ mn)	28
52w High/Low (HK\$)	3.00/1.90
Total Issued Shares (mn)	4,280

Source: Bloomberg

Shareholding Structure

Li San Yim	56.0%
GIC	7.0%
Others	37.0%

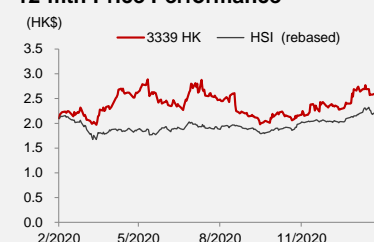
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	2.6%	-2.4%
3-mth	28.4%	12.6%
6-mth	11.7%	-6.5%

Source: Bloomberg

12-mth Price Performance



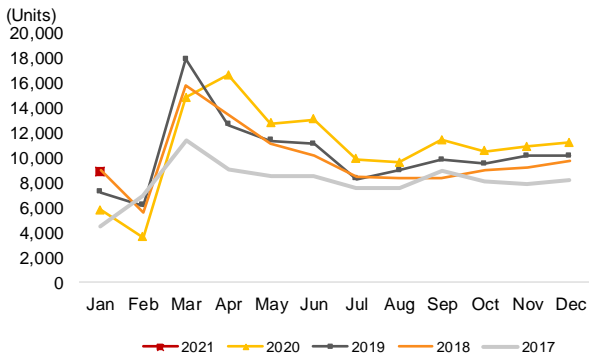
Source: Bloomberg

Auditor: Ernst & Young

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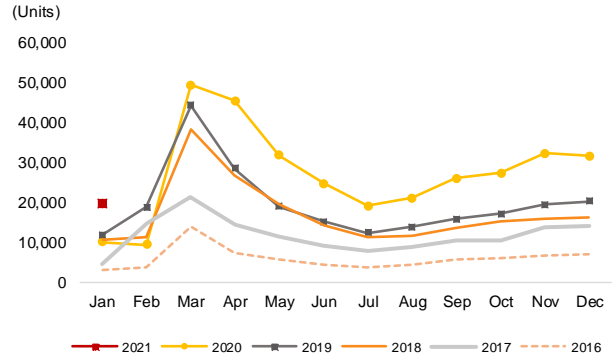
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2. China Construction Machinery Sector – Sustainable demand for excavator in 2H20E – 12 Aug 2020
3. Lonking (3339 HK, HOLD) – Weak core profit but downside protected by 12% yield – 27 Mar 2020

Figure 1: China's wheel loader sales +52% YoY in Jan



Source: CCMA, CMBIS

Figure 2: China's excavator sales +97% YoY in Jan



Source: CCMA, CMBIS

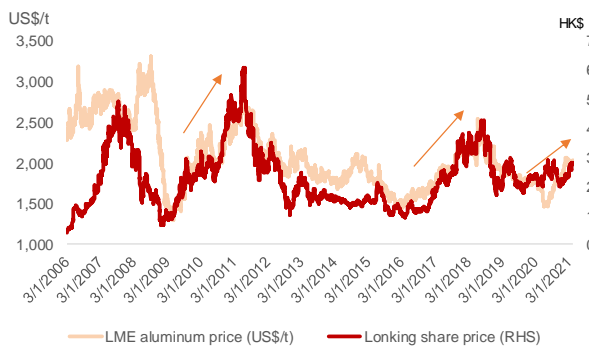
Figure 3: Key changes in assumptions on Lonking

Change in key assumptions	Old			New			Change		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
Revenue (RMB mn)									
Wheel loaders	5,827	5,632	5,576	6,065	6,221	6,159	4.1%	10.5%	10.5%
Excavators	1,954	1,915	1,896	2,077	2,243	2,221	6.3%	17.2%	17.2%
Road rollers	84	82	80	95	96	94	13.3%	16.8%	16.8%
Forklifts	2,380	2,404	2,428	2,842	3,126	3,157	19.4%	30.0%	30.0%
Others	1,162	1,220	1,281	1,162	1,220	1,281	0.0%	0.0%	0.0%
Subtotal for construction machinery	11,407	11,253	11,261	12,241	12,907	12,912	7.3%	14.7%	14.7%
Finance lease interest income	2	2	2	2	2	2	0.0%	0.0%	0.0%
Total revenue	11,409	11,255	11,263	12,243	12,909	12,915	7.3%	14.7%	14.7%
							<i>ppt</i>	<i>ppt</i>	<i>ppt</i>
Gross margin	22.8%	22.4%	22.3%	22.6%	22.5%	22.4%	-0.1	0.1	0.0
Reported net profit	1,468	1,142	1,162	1,518	1,547	1,568	3.4%	35.5%	34.9%
Core net profit	1,221	1,142	1,162	1,271	1,297	1,318	4.1%	13.6%	13.4%

Note: Core net profit excludes investment return.

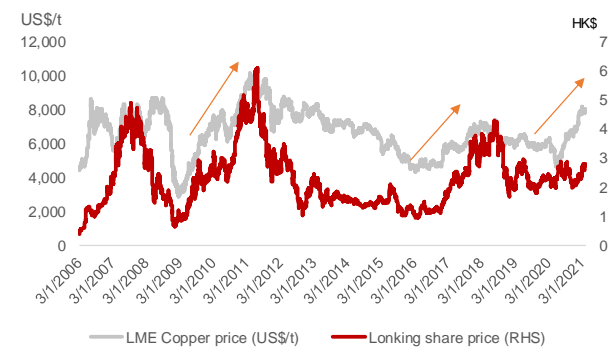
Source: Company data, CMBIS estimates

Figure 4: Lonking share price vs LME aluminium price (15-year correlation: 0.59)



Source: Bloomberg, CMBIS estimates

Figure 5: Lonking share price vs LME copper price (15-year correlation: 0.46)



Source: Bloomberg, Company data, CMBIS estimates

Valuation

We raised our TP from HK\$2.22 (7x 2020E P/E) to HK\$4.01. Our new TP is based on SOTP methodology.

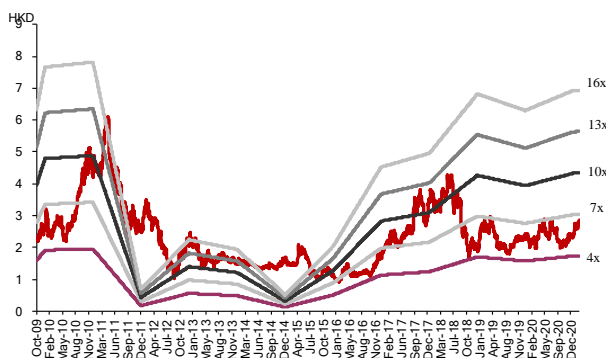
- For core business (excluding equity investment products), we apply 9x 2021E P/E. The target multiple is based on the valuation in 2017 when the non-ferrous metal prices are on an uptrend. The core business accounts for ~81% of our fair value estimate.
- For equity investment products, we apply 1x historical book value (as at Jun 2020, the fair value was RMB2.65bn).

Figure 6: SOTP valuation for Lonking

SOTP	Methodology	Valuation (RMB mn)	Fair value per share (RMB)	TP (HK\$)
Core business	9x 2021E P/E	11,670	2.73	
Investment products	1x historical P/B	2,645	0.62	
Total			3.34	4.01

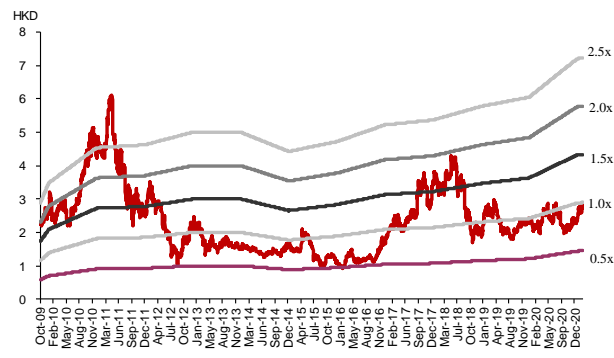
Source: Company data, CMBIS estimates

Figure 7: Lonking's P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 8: Lonking'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	11,868	11,744	12,243	12,909	12,915
Cost of sales	-9,144	-8,933	-9,472	-10,002	-10,027
Gross profit	2,725	2,811	2,772	2,907	2,887
Other income	83	102	61	65	65
Other gains and losses	-159	350	343	297	297
S&D expenses	-640	-624	-649	-684	-684
Administrative expenses	-233	-238	-251	-265	-265
R&D costs	-545	-550	-563	-594	-594
Other expenses	-1	-11	-12	-13	-13
EBIT	1,230	1,840	1,700	1,713	1,693
Net finance income	89	125	126	141	187
Finance income	136	165	150	166	212
Finance expenses	-47	-40	-25	-25	-25
Profit of JV & associates	0	0	0	0	0
Pretax profit	1,319	1,965	1,826	1,854	1,880
Income tax	-175	-321	-307	-306	-310
After tax profit	1,144	1,644	1,519	1,548	1,570
MI	-0	-1	-1	-2	-2
Net profit	1,144	1,643	1,518	1,547	1,568
Core net profit	1,337	1,272	1,271	1,297	1,318
D&A	353	349	346	345	344
EBITDA	1,583	2,190	2,046	2,057	2,037

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	1,319	1,965	1,826	1,854	1,880
Finance cost	47	40	25	25	25
Interest income	-136	-165	-150	-166	-212
Impairment of trade & other receivables	-43	14	0	0	0
Write off of inventories	-0	8	0	0	0
Depreciation and amortization	353	349	346	345	344
Interest received	89	134	150	166	212
Income tax paid	-410	-300	-307	-306	-310
Change in working capital	-604	294	-771	-39	274
Others	197	-768	0	0	0
Cash flow from operation	811	1,571	1,119	1,879	2,213
Net capex on PP&E	-320	-179	-200	-200	-100
Investment in JV/associates	0	0	0	0	0
Interest received	22	0	0	0	0
Others	740	-491	0	0	0
Cash flow from investing	442	-670	-200	-200	-100
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	-285	-594	0	0	0
Dividend paid	-549	-732	-976	-911	-928
Interest paid	-46	-43	-25	-25	-25
Others	558	404	0	0	0
Cash flow from financing	-322	-965	-1,000	-936	-953
Change in cash	931	-63	-82	743	1,160
Cash at beginning of the year	1,634	2,565	2,502	2,420	3,163
Exchange and others	1	-0	-0	0	0
Cash at the end of the year	2,565	2,502	2,420	3,163	4,323

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	3,832	3,788	3,642	3,497	3,253
PP&E	2,189	2,081	1,935	1,791	1,547
Prepaid land lease payments	176	176	176	176	176
Prepayments for PP&E	65	21	21	21	21
Long term receivables	160	249	249	249	249
Others	202	502	502	502	502
Deferred tax assets	384	404	404	404	404
Pledged deposits	656	356	356	356	356
Current assets	10,240	10,830	11,744	12,613	13,487
Inventories	2,858	3,006	3,326	3,634	3,234
Finance lease receivables	21	10	10	10	10
Trade and bills receivables	2,529	2,245	2,921	2,738	2,852
Prepayments, deposits & others	508	634	634	634	634
Others (loans & receivables)	0	0	0	0	0
Financial investments	1,337	1,837	1,837	1,837	1,837
Others	11	280	280	280	280
Pledged deposits	411	317	317	317	317
Cash	2,565	2,502	2,420	3,163	4,323
Current liabilities	4,479	4,741	4,966	5,053	5,041
Trade and bills payables	3,507	3,650	3,875	3,962	3,950
Other payables and accruals	713	786	786	786	786
Bank borrowings	0	0	0	0	0
Tax payable	124	163	163	163	163
Others	135	142	142	142	142
Non-current liabilities	1,387	799	799	799	799
Bank borrowings	1,287	709	709	709	709
Deferred tax liabilities	63	66	66	66	66
Others	37	24	24	24	24
Equity	8,207	9,077	9,621	10,258	10,899
Shareholders' equity	8,205	9,074	9,617	10,253	10,893
MI	3	3	3	5	6

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Wheel loaders	52	51	50	48	48
Excavators	18	18	17	17	17
Road rollers	1	1	1	1	1
Forklifts	19	20	23	24	24
Others	10	9	9	9	10
Finance lease interest income	0	0	0	0	0
Total	100	100	100	100	100
Profit & loss ratio (%)					
Gross margin	23.0	23.9	22.6	22.5	22.4
EBITDA margin	13.3	18.6	16.7	15.9	15.8
EBIT margin	10.4	15.7	13.9	13.3	13.1
Net profit margin	9.6	14.0	12.4	12.0	12.2
Growth (%)					
Revenue	32	-1	4	5	0
Gross profit	14	3	-1	5	-1
EBITDA	-8	38	-7	1	-1
EBIT	-10	50	-8	1	-1
Net profit	9	44	-8	2	1
Core net profit	47	-5	0	2	2
Balance sheet ratio					
Current ratio (x)	3.1	3.1	3.1	3.2	3.3
Receivable turnover days	69	74	77	80	79
Inventory turnover days	106	120	122	127	125
Payable turnover days	136	146	145	143	144
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	8.2	11.5	10.1	9.8	9.5
ROE	14.4	19.0	16.2	15.6	14.8
Per share data					
EPS (RMB)	0.27	0.38	0.35	0.36	0.37
BVPS (RMB)	1.92	2.12	2.25	2.40	2.55
DPS (RMB)	0.17	0.23	0.21	0.22	0.22

Note: Core net profit excludes investment return.

Source: Company data, CMBIS estimates

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