

China Construction Machinery

Focus on China infrastructure names amid volatile market

We are staying positive on China construction machinery and HDT sector in spite of the volatile market as result of the pandemic of COVID-19 across the globe, as major players' earnings are more driven by China market. On the other hand, while CMBI Economic Research revised down China GDP forecast to 4.5% from 5.9% for this year, we expect the impact on construction machinery sector to be limited for the full year, as a strong demand recovery in 2Q driven by accelerating construction activities will cover the lost sales in 1Q (traditional peak season). We prefer names with high exposure to China infrastructure, such as **SANY Heavy (600031 CH, BUY)** and **Jiangsu Hengli (601100 CH, BUY)** and **Sinotruk (3808 HK, BUY)**, due to relatively higher earnings visibility.

- **Near-term pressure for companies with relatively high exposure in the US and Europe.** The rising COVID-19 cases will likely exert pressure on the overseas demand in the foreseeable future. **Zhejiang Dingli (603338 CH, BUY)** has a high portion of revenue generated from the overseas (49% in 1H19), with a focus on both the US and Europe. **CIMC Vehicles (1839 HK, BUY)** generated 40% revenue from the overseas in 1H19. Of the overseas revenue, 88% came from the US and Europe. For **Weichai Power (2338 HK / 000338, BUY)**, 40% of total revenue (in 1H19) was generated from the overseas market but came mainly from **KION (KGX GR)** in which Weichai has 45% equity interest. Therefore the attributable revenue from overseas is ~20% based on our calculation.
- **Decline in overseas stock market may offer opportunities for Chinese players.** Chinese machinery/component makers such as **Weichai** and **SANY Int'l (631 HK, BUY)** have always been looking for acquisition opportunities in the overseas. A decline in overseas valuation may offer excellent opportunities for bargain hunting.
- **Key catalyst: Construction machinery and HDT demand set for recovery in 2Q.** With COVID-19 under control, economic activities are picking up in China. CMBI Economic Research forecast a 3.7% YoY decline of GDP in 1Q20E, followed by 5.5%/8.0% growth in 2Q/3Q ([report](#)). While China excavator and HDT sales in 2M20 dropped 37% and 12% YoY, respectively, we expect demand to gradually improve in Mar and the peak season will happen in 2Q, driven by infrastructure construction recovery.
- **Focus on companies with high exposure to China infrastructure.** Jiangsu Hengli has the highest exposure to infrastructure spending given its focus on hydraulic components for excavator (50% market share on cylinder) and other heavy equipment. This is followed by SANY Heavy, the largest excavator maker in China, with >80% revenue generated from China (1H19). We also like Sinotruk given its high exposure on construction truck (revenue in China: >80% of total).

OUTPERFORM
(Maintain)

China Capital Goods

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8. China Construction Machinery Sector - Excavator sales growth accelerated to 26% in Dec; above expectation – 10 Jan 2020
9. SANY Heavy Industry – A (600031 CH, BUY) – To acquire financing company from parent co. – 12 Dec 2019
10. China Construction Machinery Sector – Four structural drivers to extend the upcycle to 2020-21E – 27 Nov 2019

Figure 1: Major players' overseas revenue

Company	Revenue in overseas as % of total
Zhejiang Dingli	49%
CIMC Vehicles	40%
Weichai Power*	40%
Jiangsu Hengli**	23%
SANY International	20%
Sinotruk	17%
SANY Heavy	17%
Zoomlion	13%
Lonking	4%

Note: * Attribute overseas revenue is much lower as KION's contribution is consolidated to Weichai's financial statement.

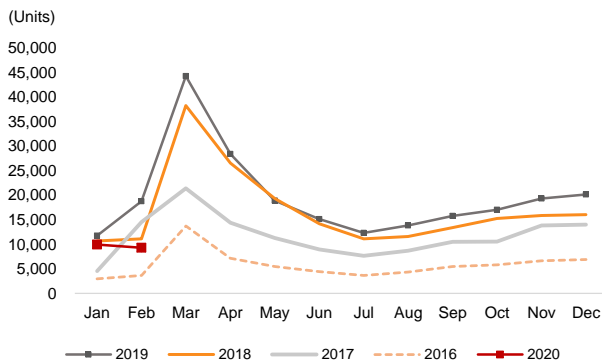
** 2018 figure for Hengli; 1H19 for all others

Source: Company data, CMBIS

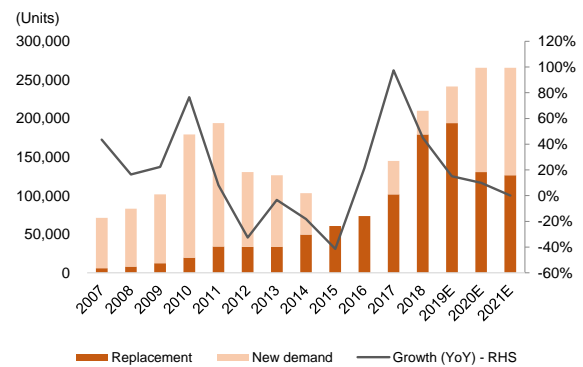
Figure 2: Exposure to end demand

Type of machinery	Infrastructure	Property	Mining
Excavator	High	Low	Medium
Wheel loader	High	Low	Medium
Truck crane	High	Medium	n/a
Tower crane	Low	High	n/a
Concrete machinery	Medium	High	n/a
Coal mining equipment	n/a	n/a	High
Mining transport truck	n/a	n/a	High
Heavy duty truck (construction)	High	Low	Low

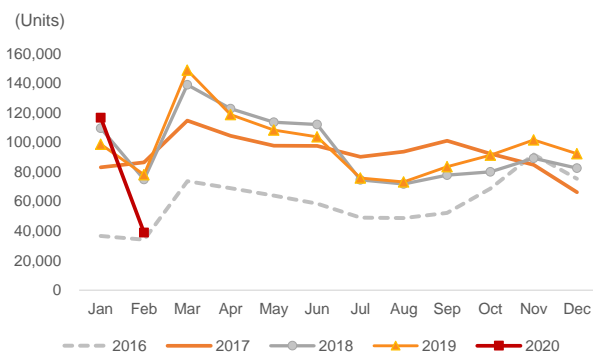
Source: CCMA, CMBIS estimates

Figure 3: China monthly excavator sales

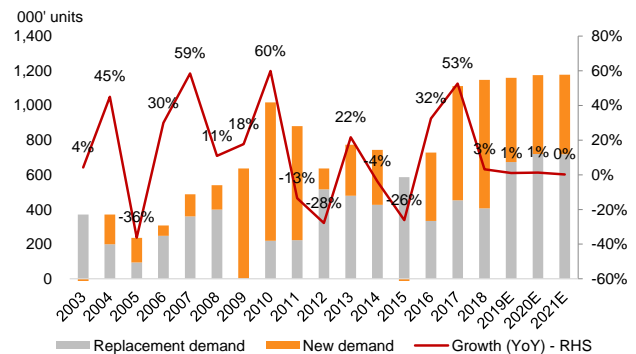
Source: CCMA, CMBIS

Figure 4: CMBI excavator sales projection

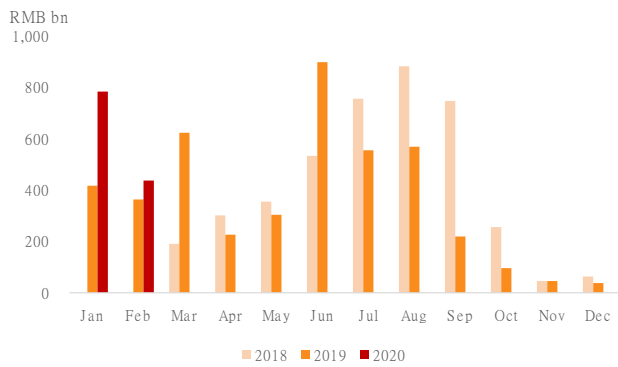
Source: CCMA, CMBIS estimates

Figure 5: China monthly HDT sales

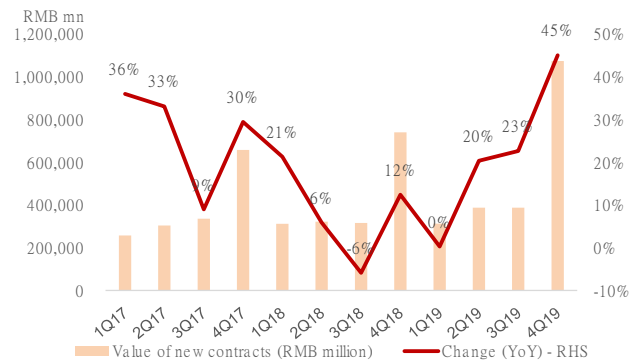
Source: Cvworl, CMBIS

Figure 6: CMBI HDT sales projection

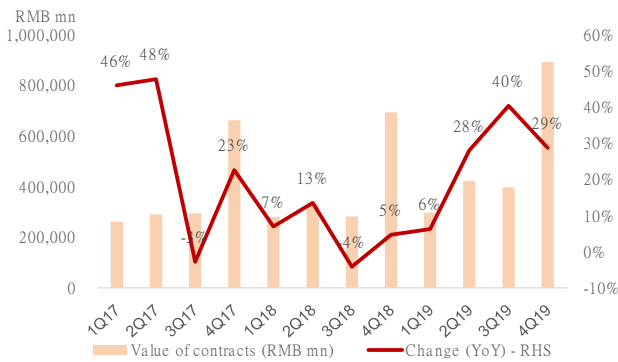
Source: Wind, CMBIS estimates

Figure 7: Local government bond issuance +56% in 2M20

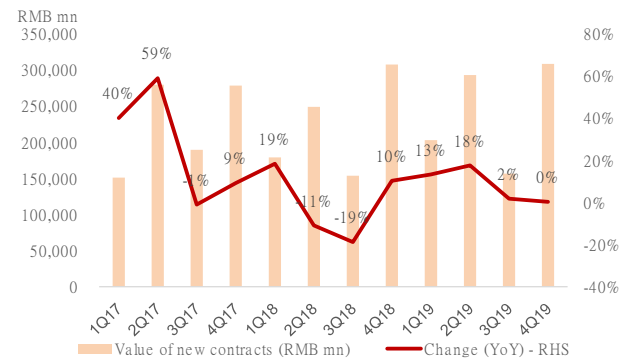
Source: MoF, CMBIS

Figure 8: CRG (390 HK) value of new contracts

Source: Company data, CMBIS

Figure 9: CRCC (1186 HK) value of new contracts

Source: Company data, CMBIS

Figure 10: CCCC (1800 HK) value of new contracts

Source: Company data, CMBIS

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