

# Lonking (3339 HK)

## Strong beat on 2020 results; Attractive yield of 12%

Lonking's net profit grew 19% YoY to RMB1.96bn, substantially exceeded our / consensus estimate by 29%/ 32%. The surprise came from the net investment gain of ~RMB577mn (versus our forecast of ~RMB250mn). Excluding the investment gain, the profit from the core business grew 8% to RMB1.37bn, 8% above our core profit estimate, due to better-than-expected excavator sales. We revise up Lonking's net profit forecast in 2021E-22E by 11-12% (20-21% above consensus), due to higher assumptions on excavator sales. We lift our SOTP-based TP to HK\$4.29 from HK\$4.01. Lonking proposed HK\$0.33 dividend per share, implying 12% yield at the current price. Maintain **BUY**.

- **2020 results highlights.** Revenue grew 10% YoY to RMB12.9bn, mainly driven by 4%/14%/14% growth of wheel loader / excavator / forklift. Gross margin slightly dropped 0.5ppt YoY to 23.4%. Lonking generated a net investment gain of RMB577mn in 2020, due to strong equity market. Proposed dividend of RMB1.17bn is higher than the operating cash inflow of RMB1.07bn. Dividend payout ratio is 60.6%, up slightly from 59.4% in 2019.
- **Strong recovery in 2H20.** In 2H20, revenue from excavator surged 59% YoY, a sharp improvement from a decline of 9% in 1H20, suggesting improvement in management execution. Wheel loader revenue grew 14% YoY in 2H20, much better than the 4% YoY decline in 1H20. Report net profit / core net profit in 2H20 grew 35% YoY / 25% YoY.
- **Strong machinery sales in 2M21 for the industry as a whole.** According to CCMA, sales volume of wheel loader / excavator by major players grew 76% YoY / 150% YoY in 2M21. We believe the robust downstream demand to continue and we believe strong industry data in Mar will serve as near term catalyst.
- **Downside risks:** (1) Market share loss due to strong competition in the excavator segment; (2) structural weakness in wheel loader demand; (3) investment loss due to weak equity market.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue (RMB mn)	11,868	11,744	12,880	14,018	14,313
YoY growth (%)	32.0	-1.0	9.7	8.8	2.1
Net income* (RMB mn)	1,144	1,643	1,959	1,713	1,755
EPS (RMB)	0.267	0.384	0.458	0.400	0.410
YoY growth (%)	9.4	43.7	19.2	-12.6	2.5
Consensus (RMB)	n/a	n/a	n/a	0.33	0.34
EV / EBITDA (x)	4.2	3.0	2.7	3.0	3.0
P/E (x)	8.9	6.3	5.0	5.6	5.5
P/B (x)	1.2	1.1	1.0	0.9	0.8
Yield (%)	7.1	9.4	12.2	10.7	10.9
ROE (%)	14.4	19.0	20.4	16.5	16.0
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

\*Reported net profit

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$4.29
(Previous TP	HK\$4.01)
Up/Downside	59%
Current Price	HK\$2.70

### China Capital Goods

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#### Stock Data

Mkt Cap (HK\$ mn)	11,556
Avg 3 mths t/o (HK\$ mn)	4
52w High/Low (HK\$)	3.08/1.90
Total Issued Shares (mn)	4,280

Source: Bloomberg

#### Shareholding Structure

Li San Yim	56.0%
GIC	7.0%
Others	37.0%

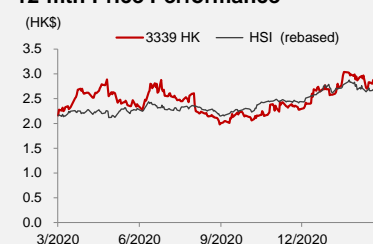
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-8.5%	-1.3%
3-mth	17.9%	11.5%
6-mth	35.0%	12.4%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Ernst & Young

#### Related Reports

1. Lonking (3339 HK, BUY) – Recovery of wheel loader sales; Proxy of metal prices; U/G to BUY – 10 Feb 2021
2. Lonking (3339 HK, SELL) – No improvement in core earnings; weakening competitive power – 27 Aug 2020

**Figure 1: 2020 results**

YE Dec 31 (RMB mn)	2019	2020	Change (YoY)	2020E	A vs E
<b>Revenue</b>					
Wheel loaders	6,026	6,284	4.3%	6,065	3.6%
Excavators	2,122	2,416	13.8%	2,077	16.3%
Road rollers	113	88	-22.0%	95	-7.0%
Forklifts	2,374	2,711	14.2%	2,842	-4.6%
Others	1,107	1,380	24.7%	1,162	18.8%
Subtotal for construction machinery	11,742	12,879	9.7%	12,241	5.2%
Finance lease interest income	2	1	-47.6%	2	-48.2%
<b>Total revenue</b>	<b>11,744</b>	<b>12,880</b>	<b>9.7%</b>	<b>12,243</b>	<b>5.2%</b>
Cost of sales	(8,933)	(9,870)	10.5%	(9,472)	4.2%
<b>Gross profit</b>	<b>2,811</b>	<b>3,010</b>	<b>7.1%</b>	<b>2,772</b>	<b>8.6%</b>
Other income	102	111	8.3%	61	80.7%
Other gains and losses	350	549	56.8%	343	60.2%
S&D expenses	(624)	(673)	7.9%	(649)	3.7%
Administrative expenses	(238)	(241)	12%	(251)	-4.0%
R&D costs	(550)	(579)	5.2%	(563)	2.8%
Other expenses	(11)	(0)	-96.5%	(12)	-96.8%
<b>EBIT</b>	<b>1,840</b>	<b>2,177</b>	<b>18.3%</b>	<b>1,700</b>	<b>28.0%</b>
Net finance income/(expense)	125	131	4.6%	126	4.2%
Finance income	165	148	-10.3%	150	-15%
Finance expenses	(40)	(17)	-56.9%	(25)	-30.4%
Share of profit of JV and associates	0	0	n/a	0	n/a
<b>Pretax profit</b>	<b>1,965</b>	<b>2,308</b>	<b>17.4%</b>	<b>1,826</b>	<b>26.4%</b>
Income tax	(321)	(348)	8.2%	(307)	13.4%
After tax profit	1,644	1,960	19.2%	1,519	29.0%
MI	(1)	(1)	-3.7%	(1)	-32.3%
<b>Net profit</b>	<b>1,643</b>	<b>1,959</b>	<b>19.2%</b>	<b>1,518</b>	<b>29.0%</b>
<b>Core net profit</b>	<b>1,272</b>	<b>1,375</b>	<b>8.2%</b>	<b>1,271</b>	<b>8.2%</b>
D&A	349	335	-4.2%	346	-3.1%
<b>EBITDA</b>	<b>2,190</b>	<b>2,512</b>	<b>14.7%</b>	<b>2,046</b>	<b>22.8%</b>

Source: Company data, CMBIS

**Figure 2: 2H20 results**

YE Dec 31 (RMB mn)	1H19	1H20	Change (YoY)	2H19	2H20	Change (YoY)
<b>Revenue</b>						
Wheel loaders	3,337	3,216	-3.6%	2,689	3,068	14.1%
Excavators	1,408	1,283	-8.9%	714	1,133	58.6%
Road rollers	72	49	-33.0%	41	40	-2.6%
Forklifts	1,351	1,349	-0.2%	1,023	1,363	33.2%
Others	590	617	4.6%	517	763	47.6%
Subtotal for construction machinery	6,758	6,513	-3.6%	4,983	6,366	27.8%
Finance lease interest income	1	1	-37.2%	1	0	-61.0%
<b>Total revenue</b>	<b>6,760</b>	<b>6,514</b>	<b>-3.6%</b>	<b>4,984</b>	<b>6,367</b>	<b>27.7%</b>
Cost of sales	(5,188)	(5,023)	-3.2%	(3,744)	(4,847)	29.5%
<b>Gross profit</b>	<b>1,571</b>	<b>1,491</b>	<b>-5.1%</b>	<b>1,240</b>	<b>1,519</b>	<b>22.6%</b>
Other income	29	39	34.8%	73	72	-2.0%
Other gains and losses	145	247	70.9%	205	302	46.9%
S&D expenses	(337)	(323)	-4.2%	(287)	(350)	22.1%
Administrative expenses	(122)	(120)	-1.6%	(117)	(121)	4.1%
R&D costs	(288)	(270)	-6.4%	(262)	(309)	18.1%
Other expenses	(10)	(0)	n/a	(1)	(0)	n/a
<b>EBIT</b>	<b>988</b>	<b>1,065</b>	<b>7.8%</b>	<b>853</b>	<b>1,112</b>	<b>30.5%</b>
Net finance income/(expense)	60	60	0.0%	65	70	8.9%
Finance income	85	74	-13.6%	80	74	-6.9%
Finance expenses	(25)	(13)	-46.3%	(15)	(4)	-74.5%
Share of profit of JV and associates	0	0	n/a	0	0	n/a
<b>Pretax profit</b>	<b>1,048</b>	<b>1,125</b>	<b>7.3%</b>	<b>917</b>	<b>1,183</b>	<b>28.9%</b>
Income tax	(159)	(181)	13.7%	(162)	(167)	2.8%
After tax profit	889	944	6.2%	755	1,016	34.5%
MI	(0)	(0)	n/a	(0)	(0)	n/a
<b>Net profit</b>	<b>889</b>	<b>944</b>	<b>6.2%</b>	<b>755</b>	<b>1,016</b>	<b>34.6%</b>
<b>Core net profit</b>	<b>727</b>	<b>696</b>	<b>-4.2%</b>	<b>544</b>	<b>679</b>	<b>24.7%</b>
D&A	177	153	-13.5%	172	182	5.4%
<b>EBITDA</b>	<b>1,165</b>	<b>1,218</b>	<b>4.5%</b>	<b>1,025</b>	<b>1,294</b>	<b>26.2%</b>
<b>Non-operating or one-off gains/(loss)</b>	<b>162</b>	<b>247</b>	<b>53.2%</b>	<b>210</b>	<b>337</b>	<b>60.0%</b>
Investment gains	164	242	47.8%	(155)	335	n/a
FX change & others	(2)	5	n/a	365	1	-99.6%
<b>Key ratios</b>			<b>Change (ppt)</b>			<b>Change (ppt)</b>
Gross margin	23.2%	22.9%	-0.4	24.9%	23.9%	-1.0
S&D expense ratio	5.0%	5.0%	0.0	5.8%	5.5%	-0.3
Admin expense ratio	1.8%	1.8%	0.0	2.3%	1.9%	-0.4
R&D expense ratio	4.3%	4.1%	-0.1	5.3%	4.9%	-0.4
Net margin	13.1%	14.5%	1.3	15.1%	16.0%	0.8

Source: Company data, CMBIS

**Figure 3: Key changes in assumptions**

Change in key assumptions	Old	New	Change
	2021E	2022E	2021E
<b>Revenue (RMB mn)</b>			
Wheel loaders	6,221	6,159	6,632
Excavators	2,243	2,221	2,730
Road rollers	96	94	88
Forklifts	3,126	3,157	3,118
Others	1,220	1,281	1,449
Subtotal for construction machinery	12,907	12,912	14,016
Finance lease interest income	2	2	2
<b>Total revenue</b>	<b>12,909</b>	<b>12,915</b>	<b>14,018</b>
<b>Gross margin</b>	22.5%	22.4%	22.6%
Reported net profit	1,547	1,568	1,713
<b>Core net profit</b>	<b>1,297</b>	<b>1,318</b>	<b>1,413</b>

Note: Core net profit excludes investment return.

Source: Company data, CMBIS estimates

## Valuation

We raised our SOTP-based TP from HK\$4.01 to HK\$4.24.

- 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 were on an uptrend. The core business accounts for ~83% of our fair value estimate.
- For equity investment products, we apply 1.1x historical book value. We slightly revise up the target P/B to 1.1x from 1.0x.

**Figure 4: New SOTP valuation for Lonking**

SOTP	Methodology	Valuation (RMB mn)	Fair value per share (RMB)	TP (HK\$)
Core business	9x 2021E P/E	12,713	2.97	
Investment products	1.1x historical P/B	2,581	0.60	
Total			3.57	4.29

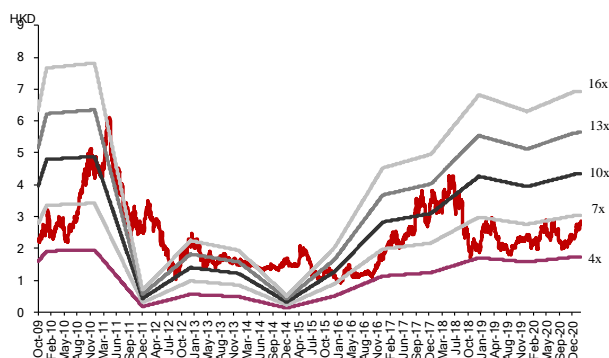
Source: Company data, CMBIS estimates

**Figure 5: Previous 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

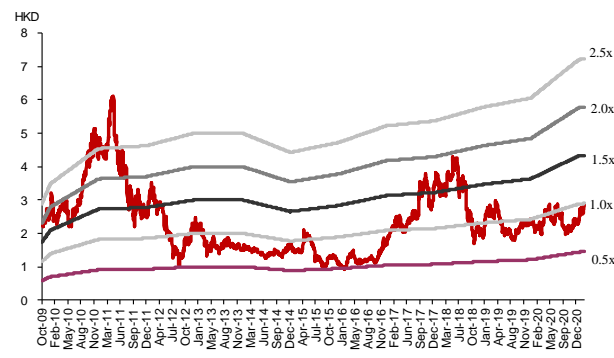
Source: Company data, CMBIS estimates

**Figure 6: Lonking's P/E band**



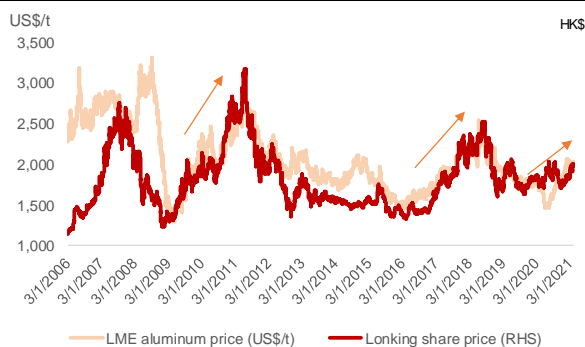
Source: Bloomberg, Company data, CMBIS estimates

**Figure 7: Lonking's P/B band**



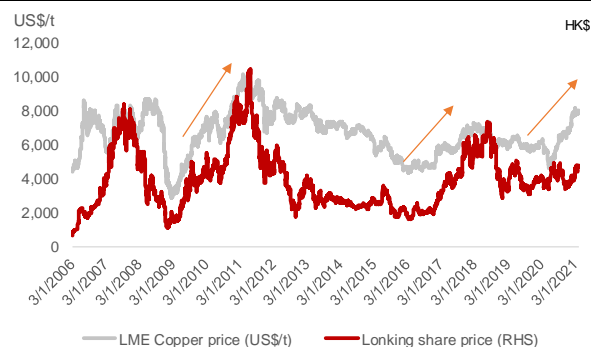
Source: Bloomberg, Company data, CMBIS estimates

**Figure 8: Lonking share price vs LME aluminium price (15-year correlation: 0.59)**



Source: Bloomberg, CMBIS estimates

**Figure 9: Lonking share price vs LME copper price (15-year correlation: 0.46)**



Source: Bloomberg, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Total revenue</b>	<b>11,868</b>	<b>11,744</b>	<b>12,880</b>	<b>14,018</b>	<b>14,313</b>
Cost of sales	(9,144)	(8,933)	(9,870)	(10,856)	(11,111)
<b>Gross profit</b>	<b>2,725</b>	<b>2,811</b>	<b>3,010</b>	<b>3,162</b>	<b>3,202</b>
Other income	83	102	111	70	72
Other gains and losses	(159)	350	549	322	329
S&D expenses	(640)	(624)	(673)	(729)	(744)
Administrative expenses	(233)	(238)	(241)	(266)	(272)
R&D costs	(545)	(550)	(579)	(659)	(673)
Other expenses	(1)	(11)	(0)	(14)	(14)
<b>EBIT</b>	<b>1,230</b>	<b>1,840</b>	<b>2,177</b>	<b>1,886</b>	<b>1,900</b>
Net finance income	89	125	131	167	204
Finance income	136	165	148	183	221
Finance expenses	(47)	(40)	(17)	(16)	(16)
Profit of JV & associates	0	0	0	0	0
<b>Pretax profit</b>	<b>1,319</b>	<b>1,965</b>	<b>2,308</b>	<b>2,053</b>	<b>2,104</b>
Income tax	(175)	(321)	(348)	(339)	(347)
After tax profit	1,144	1,644	1,960	1,714	1,757
MI	(0)	(1)	(1)	(2)	(2)
<b>Net profit</b>	<b>1,144</b>	<b>1,643</b>	<b>1,959</b>	<b>1,713</b>	<b>1,755</b>
<b>Core net profit</b>	<b>1,337</b>	<b>1,272</b>	<b>1,375</b>	<b>1,413</b>	<b>1,455</b>
D&A	353	349	335	345	345
<b>EBITDA</b>	<b>1,583</b>	<b>2,190</b>	<b>2,512</b>	<b>2,232</b>	<b>2,245</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Pretax profit</b>	<b>1,319</b>	<b>1,965</b>	<b>2,308</b>	<b>2,053</b>	<b>2,104</b>
Finance cost	47	40	17	16	16
Interest income	(136)	(165)	(148)	(183)	(221)
Impairment of trade & other receivables	(43)	14	0	0	0
Write off of inventories	(0)	8	0	0	0
Depreciation and amortization	353	349	335	345	345
Interest received	89	134	148	183	221
Income tax paid	(410)	(300)	(348)	(339)	(347)
Change in working capital	(604)	294	(440)	(279)	191
Others	197	(768)	(800)	0	0
<b>Cash flow from operation</b>	<b>811</b>	<b>1,571</b>	<b>1,071</b>	<b>1,797</b>	<b>2,309</b>
Net capex on PP&E	(320)	(179)	(280)	(200)	(100)
Investment in JV/associates	0	0	0	0	0
Interest received	22	0	0	0	0
Others	740	(491)	642	0	0
<b>Cash flow from investing</b>	<b>442</b>	<b>(670)</b>	<b>362</b>	<b>(200)</b>	<b>(100)</b>
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	(285)	(594)	(46)	0	0
Dividend paid	(549)	(732)	(976)	(1,187)	(1,028)
Interest paid	(46)	(43)	0	(16)	(16)
Others	558	404	(133)	0	0
<b>Cash flow from financing</b>	<b>(322)</b>	<b>(965)</b>	<b>(1,154)</b>	<b>(1,203)</b>	<b>(1,044)</b>
Change in cash	931	(63)	279	394	1,165
Cash at beginning of the year	1,634	2,565	2,502	2,781	3,175
Exchange and others	1	(0)	(0)	(0)	(0)
Cash at the end of the year	2,565	2,502	2,781	3,175	4,340

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Non-current assets</b>	<b>3,832</b>	<b>3,788</b>	<b>4,071</b>	<b>3,925</b>	<b>3,681</b>
PP&E	2,189	2,081	2,026	1,881	1,636
Prepaid land lease payments	176	175	169	169	169
Prepayments for PP&E	65	21	19	19	19
Long term receivables	160	249	603	603	603
Others	202	502	810	810	810
Deferred tax assets	384	404	443	443	443
Pledged deposits	656	356	0	0	0
<b>Current assets</b>	<b>10,240</b>	<b>10,830</b>	<b>13,203</b>	<b>13,475</b>	<b>15,071</b>
Inventories	2,858	3,006	3,754	3,860	3,932
Finance lease receivables	21	10	4	4	4
Trade and bills receivables	2,529	2,245	3,187	2,958	3,316
Prepayments, deposits & others	508	634	877	877	877
Others (loans & receivables)	0	0	0	0	0
Financial investments	1,337	1,837	1,538	1,538	1,538
Others	11	280	225	225	225
Pledged deposits	411	317	838	838	838
Cash	2,565	2,502	2,781	3,175	4,340
<b>Current liabilities</b>	<b>4,479</b>	<b>4,741</b>	<b>7,095</b>	<b>6,694</b>	<b>7,315</b>
Trade and bills payables	3,507	3,650	4,900	4,499	5,120
Other payables and accruals	713	786	1,059	1,059	1,059
Bank borrowings	0	0	663	663	663
Tax payable	124	163	298	298	298
Others	135	142	175	175	175
<b>Non-current liabilities</b>	<b>1,387</b>	<b>799</b>	<b>85</b>	<b>85</b>	<b>85</b>
Bank borrowings	1,287	709	0	0	0
Deferred tax liabilities	63	66	60	60	60
Others	37	24	24	24	24
<b>Equity</b>	<b>8,207</b>	<b>9,077</b>	<b>10,094</b>	<b>10,622</b>	<b>11,351</b>
Shareholders' equity	8,205	9,074	10,092	10,617	11,345
MI	3	3	2	4	6

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Sales mix (%)</b>					
Wheel loaders	52	51	49	47	47
Excavators	18	18	19	19	19
Road rollers	1	1	1	1	1
Forklifts	19	20	21	22	23
Others	10	9	11	10	11
Finance lease interest income	0	0	0	0	0
Total	100	100	100	100	100
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	23.0	23.9	23.4	22.6	22.4
EBITDA margin	13.3	18.6	19.5	15.9	15.7
EBIT margin	10.4	15.7	16.9	13.5	13.3
Net profit margin	9.6	14.0	15.2	12.2	12.3
<b>Growth (%)</b>					
Revenue	32	-1	10	9	2
Gross profit	14	3	7	5	1
EBITDA	-8	38	15	-11	1
EBIT	-10	50	18	-13	1
Net profit	9	44	19	-13	2
Core net profit	47	-5	8	3	3
<b>Balance sheet ratio</b>					
Current ratio (x)	3.1	3.1	2.4	2.6	2.6
Receivable turnover days	69	74	77	80	80
Inventory turnover days	106	120	125	128	128
Payable turnover days	136	146	158	158	158
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Profitability (%)</b>					
ROA	8.2	11.5	12.3	9.9	9.7
ROE	14.4	19.0	20.4	16.5	16.0
<b>Per share data</b>					
EPS (RMB)	0.27	0.38	0.46	0.40	0.41
BVPS (RMB)	1.92	2.12	2.36	2.48	2.65
DPS (RMB)	0.17	0.23	0.28	0.24	0.25

Note: Core net profit excludes investment return.

Source: Company data, CMBIS estimates

# Disclosures & Disclaimers

## Analyst Certification

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