

# SANY Heavy Industry – A (600031 CH)

## To acquire financing company from parent co.

SANY Heavy announced yesterday that it plans to acquire 91.43% interest in SANY Capital (“三一汽车金融”) from SANY Group (parent company of SANY Heavy) for cash consideration of RMB3.98bn. The implied valuation of 24.4x 2018 P/E and 1.5x P/B (equity as at Oct 2019) does not look attractive, in our view. Besides, an additional liability of RMB6.8bn will be consolidated in SANY Heavy's balance sheet upon completion (attributable liabilities: RMB6.4bn). That said, we believe the overall impact on SANY Heavy is limited given that the deal size is not substantial. We estimate the earnings accretive will be <1%. We have left our forecast unchanged as the deal is subject to shareholders' approval.

- **Details of the acquisition.** SANY Capital is one of the 25 auto financing companies approved by CBIRC in China. SANY Capital is mainly engaged in machinery financing business. SANY Group, parent company of SANY Heavy, currently owns 91.43% stake in SANY Capital, while SANY Heavy owns 3% interest. After the acquisition, SANY Heavy will control 94.43% stake in SANY Capital. Approval from regulators and shareholders of SANY Heavy is required before the transaction.
- **Reasons for the acquisition.** The acquisition can reduce the connected transaction. Besides, SANY Heavy believes that SANY Capital can help support the Company's overseas expansion and better control risk.
- **Financial performance of SANY Capital.** SANY Capital generated interest income of RMB235mn in 10M19 and net profit of RMB84mn. The book value as at end-Oct 2019 was RMB2.9bn while total liabilities reached RMB6.8bn, implying gearing ratio of 235%. Based on our calculation, the rate of interest income (net income / loan portfolio) ranged from 2.7% to 3.8% between 2017 and 10M19 (figure 1).
- **Not attractive due to high valuation and increased liabilities.** We calculate that the implied P/E (based on earnings in 2018) reached 24.4x. Besides, the acquisition cost of RMB3.98bn plus the increased attributable liabilities of RMB6.4bn (RMB6.8bn x 94.43%) from SANY Capital will result in a reduction of attributable net cash by >RMB10bn, though we think is still manageable due to the Company's strong free cash flow.
- **Key risks:** (1) Cyclical nature; (2) Risk of overseas business; (3) Increase in raw material cost; (4) Risk of expanding to financing business.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	38,335	55,822	76,999	88,688	95,481
YoY growth (%)	65	46	38	15	8
Net income (RMB mn)	2,092	6,116	11,127	13,352	14,473
EPS (RMB)	0.27	0.79	1.35	1.59	1.72
YoY growth (%)	925.0	189.6	70.3	17.8	8.4
EV / EBITDA (x)	22.6	15.1	8.9	7.7	7.3
P/E (x)	58.9	20.3	11.9	10.1	9.3
P/B (x)	4.8	4.0	3.0	2.5	2.2
Yield (%)	1.1	1.8	3.4	4.9	5.4
ROE (%)	8.7	21.5	29.3	27.3	25.3
Net gearing (%)	30.4	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

### BUY (Maintain)

Target Price	RMB19.00
Up/Downside	+18%
Current Price	RMB16.07

### China Capital Goods

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#### Stock Data

Mkt Cap (RMB mn)	135,354
Avg 3 mths t/o (RMB mn)	865
52w High/Low (RMB)	16.35/7.77
Total Issued Shares (mn)	8,375.6

Source: Bloomberg

#### Shareholding Structure

SANY Group	30.0%
Hong Kong CCASS	8.7%
Liang Wengen	3.4%
Others	57.89%

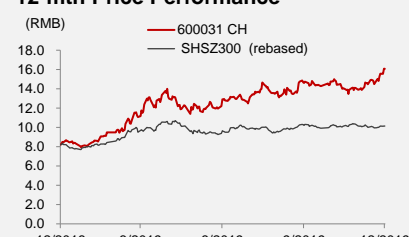
Source: Shanghai Stock Exchange

#### Share Performance

	Absolute	Relative
1-mth	+14.1%	+16.2%
3-mth	+9.6%	+11.3%
6-mth	+31.7%	+21.9%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

Auditor: Ruihua CPA

**Figure 1: Key financials of SANY Capital and valuation of acquisition**

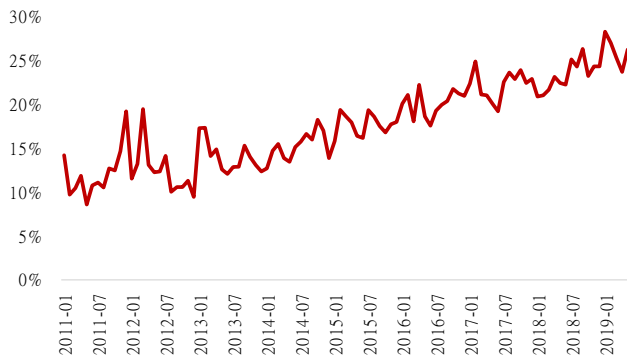
<b>Income statement (RMB mn)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>10M19</b>
<b>Revenue</b>				
Net interest income	215	219	250	235
Others	6	15	(1)	(1)
<b>Total revenue</b>	<b>221</b>	<b>234</b>	<b>249</b>	<b>234</b>
Tax and surcharge	(14)	(4)	(4)	(2)
Administrative expenses	(12)	(11)	(9)	(12)
R&D expense	0	0	(2)	(3)
Asset impairment	(75)	68	43	(86)
<b>Operating profit</b>	<b>119</b>	<b>287</b>	<b>277</b>	<b>130</b>
Other income / (expense)	10	(6)	(3)	(0)
<b>Pretax profit</b>	<b>130</b>	<b>281</b>	<b>274</b>	<b>130</b>
Income tax	(58)	(65)	(96)	(46)
<b>Net profit</b>	<b>72</b>	<b>215</b>	<b>178</b>	<b>84</b>
<b>Adjusted operating profit</b>	<b>195</b>	<b>219</b>	<b>234</b>	<b>216</b>
<b>Adjusted net profit</b>	<b>147</b>	<b>147</b>	<b>135</b>	<b>170</b>
Adjusted operating margin	88%	94%	94%	92%
Adjusted net margin	67%	63%	54%	73%

Note: Asset impairment is excluded in the calculation of adjusted figures

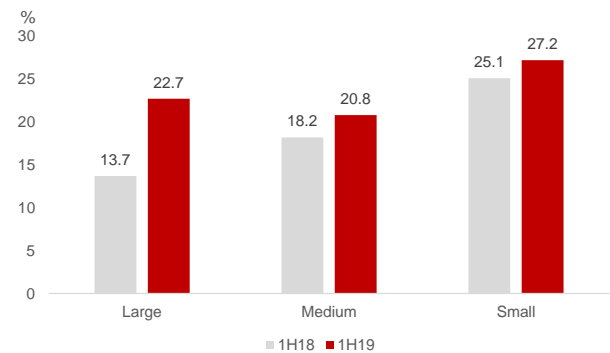
<b>Financial position (RMB mn)</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>Oct 2019</b>
<b>Assets</b>				
Loan receivables	7,226	6,523	5,620	9,139
Loan and receivable investment	1,793	886	284	0
Others	607	248	943	610
Total assets	9,627	7,656	6,846	9,750
Total liabilities	7,015	4,901	4,021	6,840
Total equity	2,612	2,755	2,826	2,909
<b>Loan portfolio</b>	<b>9,020</b>	<b>7,409</b>	<b>5,903</b>	<b>9,139</b>
Implied rate of interest income	-	2.7%	3.8%	3.7%
Total liabilities / equity	268.6%	177.9%	142.3%	235.1%
<b>ROE</b>	<b>-</b>	<b>8.0%</b>	<b>6.4%</b>	<b>3.5%</b>
<b>Adjusted ROE</b>	<b>-</b>	<b>5.5%</b>	<b>4.8%</b>	<b>7.1%</b>

<b>Valuation</b>			
Interest to acquire			91.43%
Consideration (RMB mn)			3,980
Consideration assuming 100% interest (RMB mn)			4,353
<b>Implied P/E (x) #2018</b>			<b>24.4</b>
<b>Implied P/B (x) #based on Oct 2019 equity</b>			<b>1.5</b>

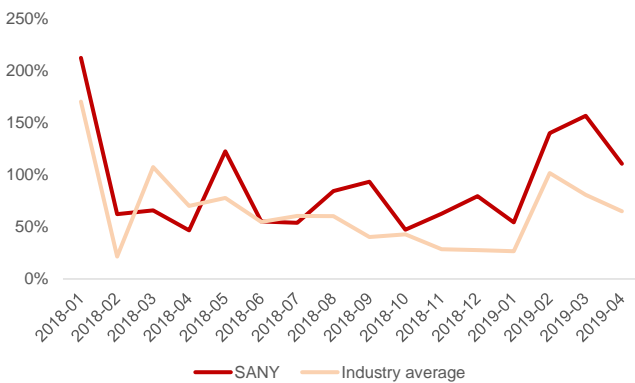
Source: Company data, CMBIS estimates

**Figure 2: SANY excavator market share in China**

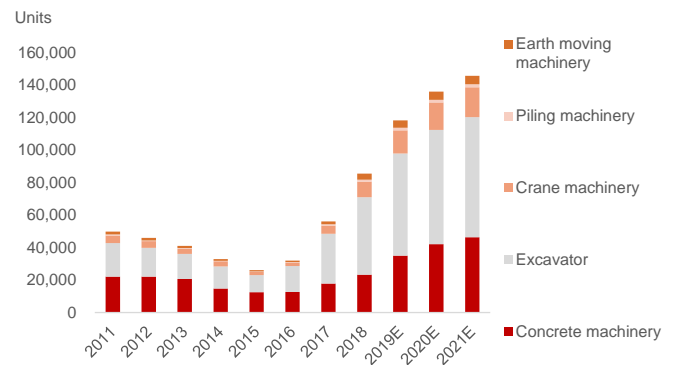
Source: Wind, CMBIS

**Figure 3: SANY's market share by size of excavator**

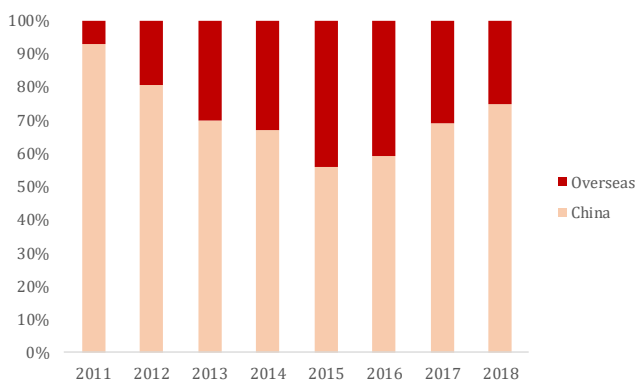
Source: Company data, CMBIS

**Figure 4: SANY truck crane sales growth vs industry**

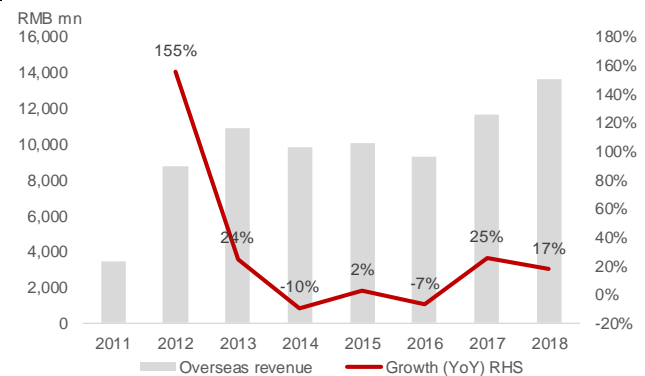
Source: Wind, CMBIS

**Figure 5: SANY's sales volume breakdown**

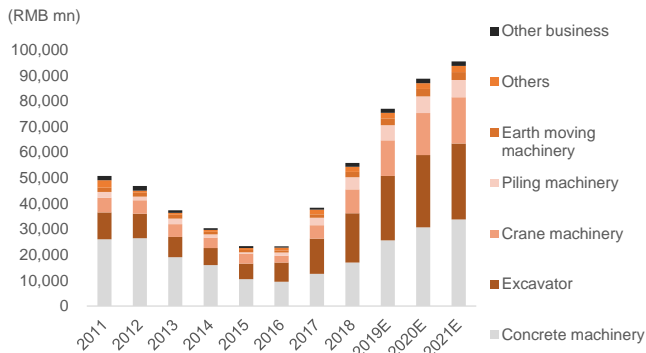
Source: Company data, CMBIS estimates

**Figure 6: SANY's revenue breakdown by region**

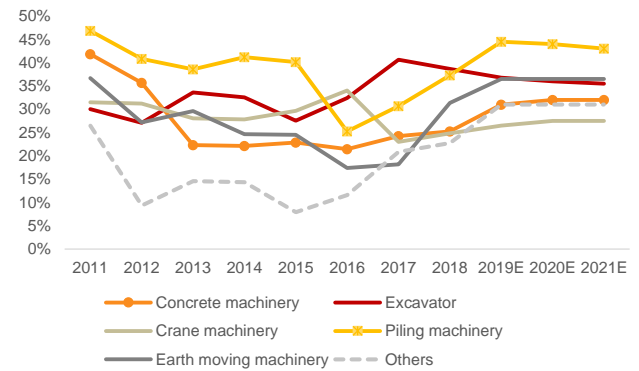
Source: Company data, CMBIS

**Figure 7: SANY's overseas revenue**

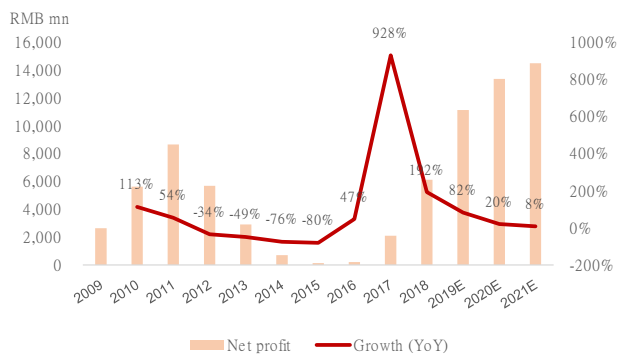
Source: Company data, CMBIS

**Figure 8: SANY revenue breakdown**

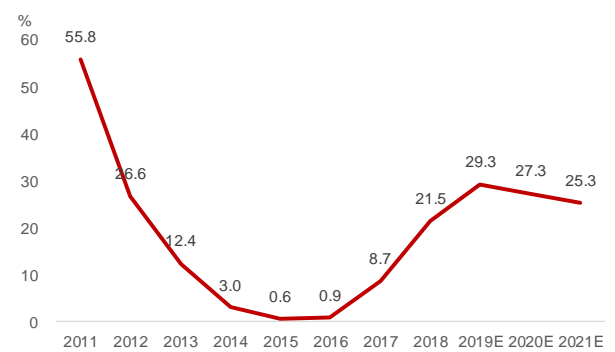
Source: Company data, CMBIS estimates

**Figure 9: SANY gross margin trend**

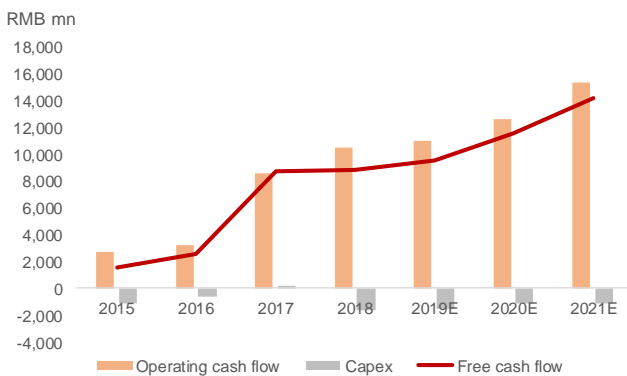
Source: Company data, CMBIS estimates

**Figure 10: SANY net profit growth**

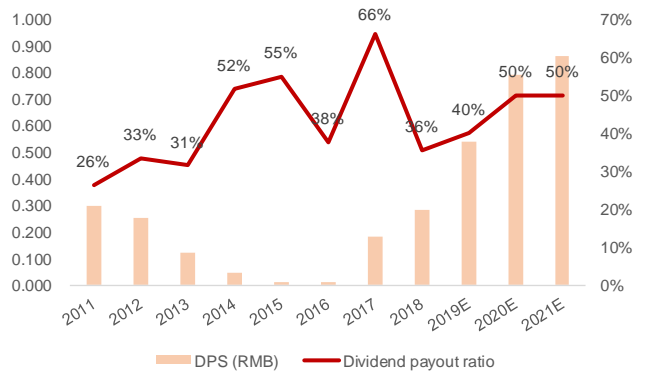
Source: Company data, CMBIS estimates

**Figure 11: SANY ROE**

Source: Company data, CMBIS estimates

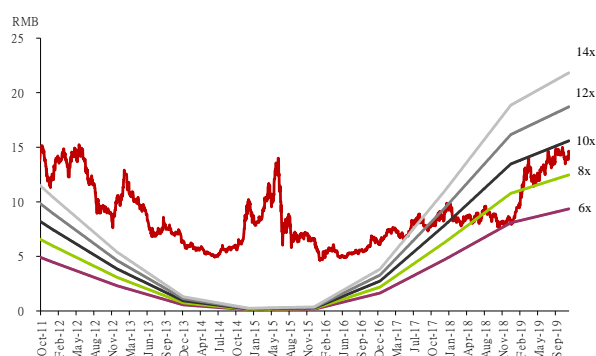
**Figure 12: SANY's free cash flow**

Source: Company data, CMBIS estimates

**Figure 13: SANY's dividend payout ratio**

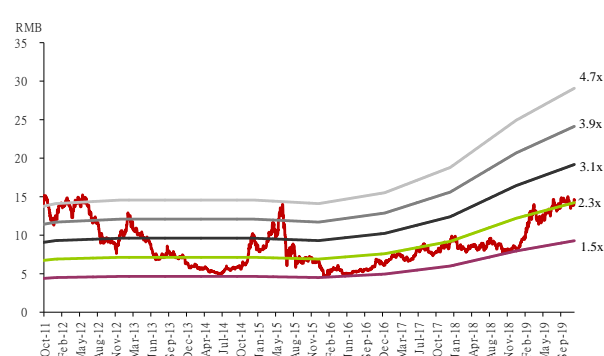
Source: Company data, CMBIS estimates

Figure 14: SANY's P/E band



Source: Company data, CMBIS estimates

Figure 15: SANY's P/B band



Source: Company data, CMBIS estimates

Figure 16: Key operating assumptions

(RMB mn)	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
<b>Revenue</b>										
Concrete machinery	26,509	19,030	16,022	10,474	9,503	12,600	16,964	25,625	30,750	33,825
Excavator	9,499	7,920	6,657	6,118	7,470	13,669	19,247	25,125	28,140	29,547
Crane machinery	5,307	5,036	4,019	3,855	2,710	5,244	9,347	13,914	16,419	18,061
Piling machinery	1,350	2,137	1,251	499	1,187	2,913	4,691	5,876	6,464	6,787
Earth moving machinery	1,543	1,489	1,019	964	875	1,343	2,132	2,673	2,941	3,088
Other machinery	808	729	737	769	1,030	1,887	1,956	2,151	2,259	2,372
<b>Revenue (construction machinery)</b>	<b>45,017</b>	<b>36,340</b>	<b>29,705</b>	<b>22,679</b>	<b>22,773</b>	<b>37,657</b>	<b>54,336</b>	<b>75,365</b>	<b>86,972</b>	<b>93,680</b>
Other business	1,814	987	660	688	507	678	1,485	1,634	1,715	1,801
<b>Total revenue</b>	<b>46,831</b>	<b>37,328</b>	<b>30,365</b>	<b>23,367</b>	<b>23,280</b>	<b>38,335</b>	<b>55,822</b>	<b>76,999</b>	<b>88,688</b>	<b>95,481</b>
<b>Revenue growth</b>										
Concrete machinery	1.8%	-28.2%	-15.8%	-34.6%	-9.3%	32.6%	34.6%	51.1%	20.0%	10.0%
Excavator	-9.3%	-16.6%	-15.9%	-8.1%	22.1%	83.0%	40.8%	30.5%	12.0%	5.0%
Crane machinery	-7.7%	-5.1%	-20.2%	-4.1%	-29.7%	93.5%	78.3%	48.9%	18.0%	10.0%
Piling machinery	-39.7%	58.3%	-41.5%	-60.1%	137.7%	145.5%	61.0%	25.3%	10.0%	5.0%
Earth moving machinery	-7.8%	-3.5%	-31.6%	-5.4%	-9.3%	53.6%	58.7%	25.4%	10.0%	5.0%
Other machinery	-72.0%	-9.8%	1.1%	4.3%	34.0%	83.3%	3.6%	10.0%	5.0%	5.0%
<b>Revenue (construction machinery)</b>	<b>-8.3%</b>	<b>-19.3%</b>	<b>-18.3%</b>	<b>-23.7%</b>	<b>0.4%</b>	<b>65.4%</b>	<b>44.3%</b>	<b>38.7%</b>	<b>15.4%</b>	<b>7.7%</b>
Other business	6.1%	-45.6%	-33.2%	4.3%	-26.4%	33.9%	118.9%	10.0%	5.0%	5.0%
<b>Total revenue</b>	<b>-7.8%</b>	<b>-20.3%</b>	<b>-18.7%</b>	<b>-23.0%</b>	<b>-0.4%</b>	<b>64.7%</b>	<b>45.6%</b>	<b>37.9%</b>	<b>15.2%</b>	<b>7.7%</b>
<b>Gross margin</b>										
Concrete machinery	35.7%	22.3%	22.1%	22.8%	21.5%	24.2%	25.2%	31.0%	32.0%	32.0%
Excavator	27.1%	33.6%	32.6%	27.5%	32.4%	40.6%	38.7%	36.8%	36.0%	35.5%
Crane machinery	31.2%	28.0%	27.8%	29.7%	34.0%	23.0%	24.8%	26.5%	27.5%	27.5%
Piling machinery	40.8%	38.6%	41.2%	40.1%	25.2%	30.7%	37.3%	44.5%	44.0%	43.0%
Earth moving machinery	27.2%	29.6%	24.6%	24.5%	17.4%	18.2%	31.3%	36.5%	36.5%	36.5%
Other machinery	9.3%	14.6%	14.3%	7.9%	11.6%	20.9%	22.7%	31.0%	31.0%	31.0%
<b>Gross margin (construction machinery)</b>	<b>32.7%</b>	<b>26.7%</b>	<b>25.9%</b>	<b>25.2%</b>	<b>26.1%</b>	<b>30.1%</b>	<b>31.1%</b>	<b>33.4%</b>	<b>33.5%</b>	<b>33.2%</b>
Other business	7.0%	8.0%	19.0%	10.3%	28.9%	27.7%	12.5%	11.0%	11.0%	11.0%
<b>Blended gross margin</b>	<b>31.7%</b>	<b>26.2%</b>	<b>25.8%</b>	<b>24.8%</b>	<b>26.2%</b>	<b>30.1%</b>	<b>30.6%</b>	<b>32.9%</b>	<b>33.0%</b>	<b>32.7%</b>

Source: Company data, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Total revenue</b>	<b>38,335</b>	<b>55,822</b>	<b>76,999</b>	<b>88,688</b>	<b>95,481</b>
Cost of sales	(26,806)	(38,728)	(51,684)	(59,396)	(64,222)
<b>Gross profit</b>	<b>11,529</b>	<b>17,094</b>	<b>25,314</b>	<b>29,292</b>	<b>31,259</b>
Surcharge	(279)	(326)	(462)	(532)	(573)
S&D expenses	(3,832)	(4,447)	(5,390)	(6,119)	(6,493)
Administrative expenses	(2,533)	(3,800)	(5,005)	(5,676)	(6,111)
Fair value change	403	(362)	0	0	0
Asset impairment	(1,189)	(1,095)	(1,155)	(1,330)	(1,432)
<b>EBIT</b>	<b>4,098</b>	<b>7,063</b>	<b>13,303</b>	<b>15,634</b>	<b>16,650</b>
Net finance income/(cost)	(1,319)	(136)	263	674	1,040
Finance income	72	344	687	1,003	1,360
Finance expenses	(1,391)	(479)	(425)	(329)	(320)
Other gains/(losses)	(13)	495	0	0	0
Profit of JV and associates	102	128	172	176	178
<b>Pretax profit</b>	<b>2,869</b>	<b>7,550</b>	<b>13,737</b>	<b>16,485</b>	<b>17,869</b>
Income tax	(642)	(1,247)	(2,267)	(2,720)	(2,948)
<b>After tax profit</b>	<b>2,227</b>	<b>6,303</b>	<b>11,471</b>	<b>13,765</b>	<b>14,921</b>
MI	(135)	(187)	(344)	(413)	(448)
<b>Net profit</b>	<b>2,092</b>	<b>6,116</b>	<b>11,127</b>	<b>13,352</b>	<b>14,473</b>
<b>Recurring net profit</b>	<b>2,092</b>	<b>6,116</b>	<b>11,127</b>	<b>13,352</b>	<b>14,473</b>
D&A	1,913	1,932	1,935	1,950	1,962
<b>EBITDA</b>	<b>6,012</b>	<b>8,995</b>	<b>15,238</b>	<b>17,584</b>	<b>18,612</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Pretax profit	2,869	7,550	13,737	16,485	17,869
Finance cost	1,271	388	425	329	320
Interest income	(72)	(344)	(687)	(1,003)	(1,360)
Profit or loss of associates	(102)	(128)	(172)	(176)	(178)
Fair value change	(383)	(276)	0	0	0
Provision for assets	903	(8)	0	0	0
Depreciation and amortization	1,913	1,932	1,935	1,950	1,962
Income tax paid	(642)	(1,247)	(2,267)	(2,720)	(2,948)
Change in working capital	2,126	1,788	(1,924)	(2,190)	(325)
Others	682	870	0	0	0
<b>Cash flow from operation</b>	<b>8,565</b>	<b>10,527</b>	<b>11,047</b>	<b>12,674</b>	<b>15,339</b>
Net capex on PP&E	(34)	(1,003)	(1,400)	(1,000)	(1,000)
Investment in JV/associates	229	(648)	(100)	(100)	(100)
Investment in subsidiaries	2,046	311	0	0	0
Dividend received	19	13	17	18	18
Interest received	72	344	687	1,003	1,360
Others	(1,115)	(9,781)	(70)	(70)	(0)
<b>Cash flow from investing</b>	<b>1,218</b>	<b>(10,765)</b>	<b>(865)</b>	<b>(149)</b>	<b>278</b>
Equity financing/(repurchase)	0	0	0	0	0
Net bank borrowings	(12,158)	1,584	(1,000)	(300)	(200)
Dividend paid	(229)	(1,233)	(2,178)	(4,451)	(6,676)
Interest paid	(1,391)	(479)	(425)	(329)	(320)
Others	695	955	0	0	0
<b>Cash flow from financing</b>	<b>(13,085)</b>	<b>827</b>	<b>(3,602)</b>	<b>(5,079)</b>	<b>(7,195)</b>
Change in cash	(3,302)	589	6,579	7,446	8,421
Cash at beginning of the year	7,442	4,104	11,985	18,564	26,010
Exchange and others	(36)	7,293	0	0	0
Cash at the end of the year	4,104	11,985	18,564	26,010	34,431

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>22,030</b>	<b>21,879</b>	<b>21,781</b>	<b>21,176</b>	<b>20,533</b>
PP&E	12,805	11,867	11,717	11,157	10,587
JV/associates	1,404	2,328	2,583	2,842	3,102
Goodwill	51	51	51	51	51
LT trade receivables	273	366	478	494	552
Intangible assets	4,092	3,880	3,564	3,245	2,853
AFS investments	681	1,121	1,121	1,121	1,121
Others	1,272	1,115	1,115	1,115	1,115
Deferred tax assets	1,452	1,152	1,152	1,152	1,152
<b>Current assets</b>	<b>36,207</b>	<b>51,896</b>	<b>64,704</b>	<b>75,695</b>	<b>86,634</b>
Inventories	7,642	11,595	13,894	15,397	16,274
Trade and bills receivables	19,239	20,802	23,499	26,069	26,772
Other receivables	1,789	1,704	2,937	2,408	3,347
Others	2,696	3,272	3,272	3,272	3,272
Cash	4,104	11,985	18,564	26,010	34,431
<b>Current liabilities</b>	<b>22,983</b>	<b>33,935</b>	<b>38,153</b>	<b>39,524</b>	<b>41,876</b>
Trade and bills payables	10,938	17,191	21,608	22,979	25,231
Bank borrowings	5,256	8,336	8,136	8,136	8,236
Tax payable	533	524	524	524	524
Others	2,446	3,567	3,567	3,567	3,567
<b>Non-current liabilities</b>	<b>8,882</b>	<b>7,337</b>	<b>2,504</b>	<b>2,204</b>	<b>1,904</b>
Bank borrowings	7,577	5,974	1,141	841	541
Deferred tax liabilities	646	650	650	650	650
Others	406	471	471	471	471
<b>Equity</b>	<b>26,373</b>	<b>32,502</b>	<b>45,829</b>	<b>55,143</b>	<b>63,387</b>
Shareholders' equity	25,498	31,485	44,467	53,369	61,166
MI	876	1,017	1,361	1,774	2,222

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Concrete machinery	33%	30%	33%	35%	35%
Excavator	36%	34%	33%	32%	31%
Crane machinery	14%	17%	18%	19%	19%
Piling machinery	8%	8%	8%	7%	7%
Earth moving machinery	4%	4%	3%	3%	3%
Other machinery	5%	4%	3%	3%	2%
Other business	2%	3%	2%	2%	2%
Total	100%	100%	100%	100%	100%
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	30.1	30.6	32.9	33.0	32.7
EBIT margin	10.7	12.7	17.3	17.6	17.4
Net profit margin	5.8	11.3	14.9	15.5	15.6
<b>Growth (%)</b>					
Revenue	64.7	45.6	37.9	15.2	7.7
Gross profit	89.0	48.3	48.1	15.7	6.7
EBIT	n/a	n/a	88.3	17.5	6.5
Net profit	928.5	192.3	81.9	20.0	8.4
<b>Balance sheet ratio</b>					
Current ratio (x)	1.6	1.5	1.7	1.9	2.1
Receivable turnover days	182	133	107	104	103
Inventory turnover days	94	91	90	90	90
Payable turnover days	126	133	137	137	137
Net debt / total equity (%)	30.4	Net cash	Net cash	Net cash	Net cash
<b>Profitability (%)</b>					
ROA	3.5	9.3	13.9	14.6	14.2
ROE	8.7	21.5	29.3	27.3	25.3
<b>Per share data</b>					
EPS (RMB)	0.27	0.79	1.35	1.59	1.72
BVPS (RMB)	3.33	4.04	5.28	6.34	7.27
DPS (RMB)	0.18	0.28	0.54	0.79	0.86

Source: Company data, CMBIS estimates

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