

# Lonking (3339 HK)

## Potential earnings peak; Staying on the sideline

Lonking's market share loss on both wheel loader and excavator in 1H19 and management's conservative post-result comments suggested that the growth outlook is uncertain. We believe Lonking's earnings has reached a peak. We are incrementally concerned about the outlook of wheel loaders due to the threat of substitution by small-size excavators. We trimmed our 2020E-21E earnings forecasts by 9-10%. While the stock looks attractive at 5x 2019E P/E and 13% dividend yield, we see a lack of catalyst to trigger re-rating in the near term. We reset our TP at HK\$1.90, based on 5x 2019E P/E, equivalent to the historical trough valuation. Maintain **HOLD**.

- Highlight of 1H19 results.** Net profit grew 26% YoY to RMB889mn. That said, excluding the fair value gains on investment and other non-recurring items, core net profit dropped 1.7% YoY to RMB727mn based on our estimates. Revenue slightly increased 1.7% YoY to RMB6.76bn. Gross margin was stable YoY at 23.2%, mainly due to higher margin of wheel loader helped by VAT cut which more than offset the margin decline in excavator. SG&A ratio was largely stable. Operating cash inflow reached RMB850mn, up 2.7x YoY.
- Market share loss a concern.** Lonking's wheel loader's sales volume dropped 2% YoY to 15.4k units in 1H19, versus the industry growth of 1.6% (CCMA figures). We calculated this implied market share of 23.1% in 1H19, down from 24.4% in 2018. Lonking's excavator sales volume grew 7.5% YoY in 1H19, below the 13% growth for the industry a whole. Management remains conservative regarding the sales outlook, in particular on excavator.
- Distressed valuation but lack of catalyst.** Management revealed that it targets to stick with the previous dividend payout policy going forward. Assuming a 64% payout ratio (same as 2018), the stock is trading at ~13% yield presently. Besides, as at end-Jun, Lonking's net cash and financial investment amounted to RMB4.6bn, which represent >60% of the current market cap. However, with the lack of meaningful earnings growth, it's unlikely to see re-rating in the near term.
- Upside risks:** (1) recovery of wheel loader sales; (2) to become an acquisition target. **Downside risks:** (1) slowdown of construction activities; (2) substitution risk of wheel loader; (3) investment loss.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	8,994	11,868	12,232	12,413	12,569
YoY growth (%)	74.8	32.0	3.1	1.5	1.3
Net income (RMB mn)	1,046	1,144	1,459	1,312	1,321
EPS (RMB)	0.24	0.27	0.34	0.31	0.31
YoY growth (%)	126.4	9.4	27.6	-10.1	0.7
EV / EBITDA (x)	2.3	2.5	2.0	2.2	2.2
P/E (x)	6.4	6.3	5.0	5.6	5.5
P/B (x)	0.9	0.9	0.8	0.8	0.7
Yield (%)	8.1	10.2	12.8	11.5	11.6
ROE (%)	14.5	14.4	17.0	14.4	13.8
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

### HOLD (Maintain)

Target Price	HK\$1.90
(Previous TP)	HK\$3.15)
Up/Downside	+0.5%
Current Price	HK\$1.89

### China Capital Goods

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#### Stock Data

Mkt Cap (HK\$ mn)	8,089
Avg 3 mths t/o (HK\$ mn)	26
52w High/Low (HK\$)	3.30/1.66
Total Issued Shares (mn)	4,280

Source: Bloomberg

#### Shareholding Structure

Li San Yim	56.0%
GIC	7.0%
Others	37.0%

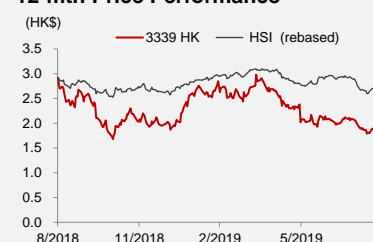
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-11.0%	-1.3%
3-mth	-20.9%	-15.4%
6-mth	-29.3%	-20.9%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Ernst & Young

#### Related Reports

- China Construction Machinery Sector – Further upside on potential earnings upside – 16 Apr
- Lonking (3339 HK, HOLD) – Surprisingly weak wheel loader sales in Jan – 15 Feb

**Figure 1: Highlight on 1H19 results**

YE Dec 31 (RMB mn)	1H18	1H19	Change (YoY)
<b>Total revenue</b>	<b>6,648</b>	<b>6,760</b>	<b>1.7%</b>
Cost of sales	(5,106)	(5,188)	1.6%
<b>Gross profit</b>	<b>1,542</b>	<b>1,571</b>	<b>1.9%</b>
Other income	12	29	132.6%
Other gains and losses	(45)	145	n/a
S&D expenses	(342)	(337)	-1.4%
Administrative expenses	(125)	(122)	-2.7%
R&D costs	(265)	(288)	8.9%
Other expenses	(1)	(10)	1104.6%
<b>EBIT</b>	<b>777</b>	<b>988</b>	<b>27.1%</b>
Net finance income/(expense)	48	60	26.5%
Finance income	66	85	28.6%
Finance expenses	(19)	(25)	33.9%
Share of profit of JV and associates	0	0	n/a
<b>Pretax profit</b>	<b>825</b>	<b>1,048</b>	<b>27.1%</b>
Income tax	(121)	(159)	32.0%
After tax profit	704	889	26.3%
MI	(0)	(0)	239.5%
<b>Net profit</b>	<b>704</b>	<b>889</b>	<b>26.2%</b>
<b>Core net profit</b>	<b>740</b>	<b>727</b>	<b>-1.7%</b>
D&A	175	177	1.2%
<b>EBITDA</b>	<b>952</b>	<b>1,165</b>	<b>22.4%</b>

Source: Company data, CMBIS

**Figure 2: 1H19 operating figures**

	1H18	1H19	Change (YoY)
<b>Sales volume (units)</b>			
Wheel loaders	15,686	15,366	-2.0%
Excavators	4,089	4,395	7.5%
Road rollers	365	310	-15.1%
Forklifts	27,871	29,372	5.4%
<b>ASP (RMB/unit)</b>			
Wheel loaders	212,722	217,193	2.1%
Excavators	337,180	320,261	-5.0%
Road rollers	235,430	233,652	-0.8%
Forklifts	46,346	46,008	-0.7%
<b>Revenue (RMB mn)</b>			
Wheel loaders	3,337	3,337	0.0%
Excavators	1,379	1,408	2.1%
Road rollers	86	72	-15.7%
Forklifts	1,292	1,351	4.6%
Others	553	590	6.6%
Subtotal for construction machinery	6,646	6,758	1.7%
Finance lease interest income	2	1	-33.2%
<b>Total revenue</b>	<b>6,648</b>	<b>6,760</b>	<b>1.7%</b>
<b>Gross margin</b>			<b>Change ppt</b>
Wheel loaders	27.2%	29.9%	2.73
Excavators	27.9%	20.4%	-7.57
Road rollers	21.7%	15.9%	-5.79
Forklifts	12.3%	14.2%	1.91

Source: Company data, CMBIS

Figure 3: Key changes in assumptions

Change in key assumptions	Old			New			Change		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
<b>Sales volume (units)</b>									
Wheel loaders	31,920	32,877	33,206	29,018	29,308	29,308	-9.1%	-10.9%	-11.7%
Excavators	7,910	8,543	8,970	6,613	6,811	6,947	-16.4%	-20.3%	-22.6%
Road rollers	685	713	720	593	605	617	-13.5%	-15.1%	-14.3%
Forklifts	54,006	56,706	59,542	53,501	55,641	57,311	-0.9%	-1.9%	-3.7%
<b>Growth (YoY)</b>							<i>ppt</i>	<i>ppt</i>	<i>ppt</i>
Wheel loaders	10.0%	3.0%	1.0%	0.0%	1.0%	0.0%	-10.0	-2.0	-1.0
Excavators	28.0%	8.0%	5.0%	7.0%	3.0%	2.0%	-21.0	-5.0	-3.0
Road rollers	4.0%	4.0%	1.0%	-10.0%	2.0%	2.0%	-14.0	-2.0	1.0
Forklifts	7.0%	5.0%	5.0%	6.0%	4.0%	3.0%	-1.0	-1.0	-2.0
<b>ASP (RMB/unit)</b>									
Wheel loaders	212,500	210,000	210,000	217,190	216,000	215,000	2.2%	2.9%	2.4%
Excavators	343,000	343,000	342,000	320,250	310,000	310,000	-6.6%	-9.6%	-9.4%
Road rollers	235,000	235,000	229,000	234,000	230,000	230,000	-0.4%	-2.1%	0.4%
Forklifts	46,000	46,000	46,000	46,000	46,000	46,000	0.0%	0.0%	0.0%
<b>Revenue (RMB mn)</b>									
Wheel loaders	6,783	6,904	6,973	6,302	6,331	6,301	-7.1%	-8.3%	-9.6%
Excavators	2,713	2,930	3,068	2,118	2,111	2,154	-22.0%	-27.9%	-29.8%
Road rollers	161	168	165	139	139	142	-13.8%	-16.9%	-13.9%
Forklifts	2,484	2,608	2,739	2,461	2,560	2,636	-0.9%	-1.9%	-3.7%
Others	1,223	1,284	1,348	1,209	1,270	1,333	-1.1%	-1.1%	-1.1%
Subtotal for construction machinery	13,364	13,894	14,293	12,229	12,410	12,566	-8.5%	-10.7%	-12.1%
Finance lease interest income	3	3	3	3	3	3	0.0%	1.0%	2.0%
<b>Total revenue</b>	<b>13,367</b>	<b>13,898</b>	<b>14,296</b>	<b>12,232</b>	<b>12,413</b>	<b>12,569</b>	<b>-8.5%</b>	<b>-10.7%</b>	<b>-12.1%</b>
<b>Gross margin</b>							<i>ppt</i>	<i>ppt</i>	<i>ppt</i>
Wheel loaders	25.8%	25.8%	25.7%	29.5%	29.0%	28.5%	3.7	3.2	2.8
Excavators	30.5%	30.3%	30.3%	20.0%	20.0%	21.0%	-10.5	-10.3	-9.3
Road rollers	18.5%	18.5%	17.5%	15.9%	15.8%	15.8%	-2.6	-2.7	-1.7
Forklifts	12.8%	12.8%	12.8%	14.2%	14.0%	14.0%	1.4	1.2	1.2

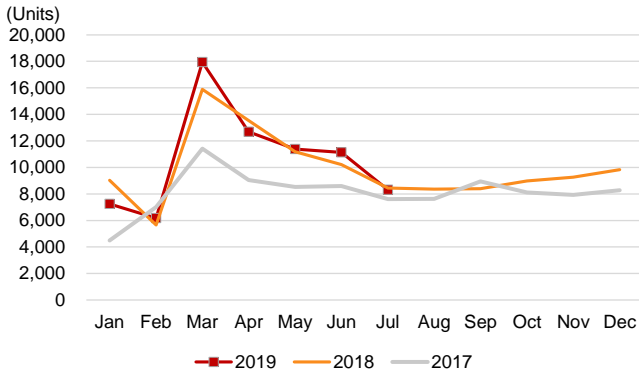
Source: Company data, CMBIS

Figure 4: Key operating assumptions

	2017	2018	2019E	2020E	2021E
<b>Sales volume (units)</b>					
Wheel loaders	23,576	29,018	29,018	29,308	29,308
Excavators	3,945	6,180	6,613	6,811	6,947
Road rollers	520	659	593	605	617
Forklifts	40,150	50,473	53,501	55,641	57,311
<b>Growth (YoY)</b>					
Wheel loaders	65.4%	23.1%	0.0%	1.0%	0.0%
Excavators	130.0%	56.7%	7.0%	3.0%	2.0%
Road rollers	51.6%	26.7%	-10.0%	2.0%	2.0%
Forklifts	53.9%	25.7%	6.0%	4.0%	3.0%
<b>ASP (RMB/unit)</b>					
Wheel loaders	204,693	212,078	217,190	216,000	215,000
Excavators	337,009	341,663	320,250	310,000	310,000
Road rollers	228,608	240,974	234,000	230,000	230,000
Forklifts	45,488	45,735	46,000	46,000	46,000
<b>Revenue (RMB mn)</b>					
Wheel loaders	4,826	6,154	6,302	6,331	6,301
Excavators	1,330	2,111	2,118	2,111	2,154
Road rollers	119	159	139	139	142
Forklifts	1,826	2,308	2,461	2,560	2,636
Others	888	1,132	1,209	1,270	1,333
Subtotal for construction machinery	8,989	11,865	12,229	12,410	12,566
Finance lease interest income	5	3	3	3	3
<b>Total revenue</b>	<b>8,994</b>	<b>11,868</b>	<b>12,232</b>	<b>12,413</b>	<b>12,569</b>
<b>Growth (YoY)</b>					
Wheel loaders	84.6%	27.5%	2.4%	0.4%	-0.5%
Excavators	126.7%	58.8%	0.3%	-0.3%	2.0%
Road rollers	62.0%	33.6%	-12.6%	0.3%	2.0%
Forklifts	49.7%	26.4%	6.6%	4.0%	3.0%
Others	38.3%	27.4%	6.8%	5.0%	5.0%
Subtotal for sale of construction machinery	75.0%	32.0%	3.1%	1.5%	1.3%
Finance lease interest income	-46.0%	-34.5%	-10.0%	1.0%	1.0%
Total revenue	74.8%	32.0%	3.1%	1.5%	1.3%
<b>Gross margin</b>					
Wheel loaders	32.6%	25.7%	29.5%	29.0%	28.5%
Excavators	29.5%	29.1%	20.0%	20.0%	21.0%
Road rollers	26.5%	18.4%	15.9%	15.8%	15.8%
Forklifts	13.9%	12.6%	14.2%	14.0%	14.0%
Others	15.2%	18.4%	18.0%	18.0%	18.0%

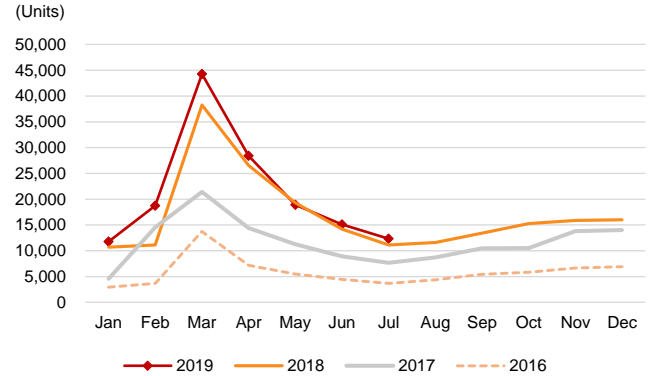
Source: Company data, CMBIS

**Figure 5: China's wheel loader monthly sales**



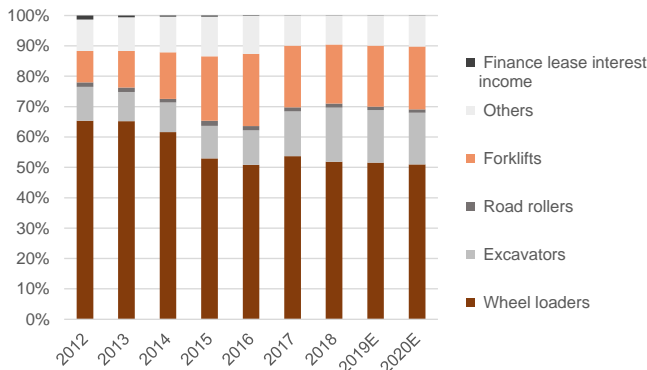
Source: CCMA, CMBIS

**Figure 6: China's excavator monthly sales**



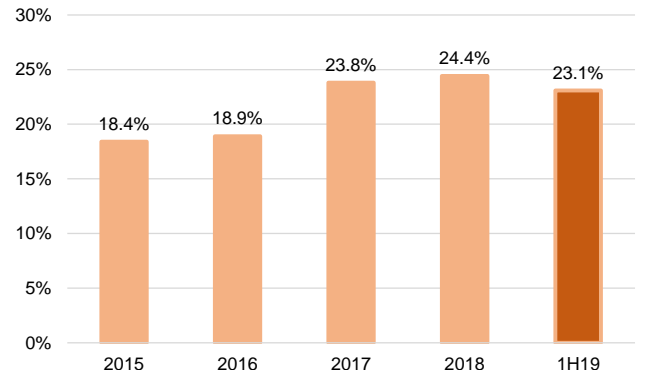
Source: CCMA, CMBIS

**Figure 7: Lonking's revenue breakdown**



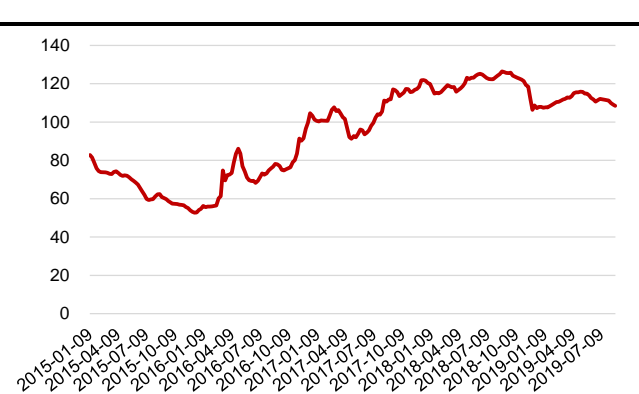
Source: Company data, CMBIS estimates

**Figure 8: Lonking's wheel loader market share**



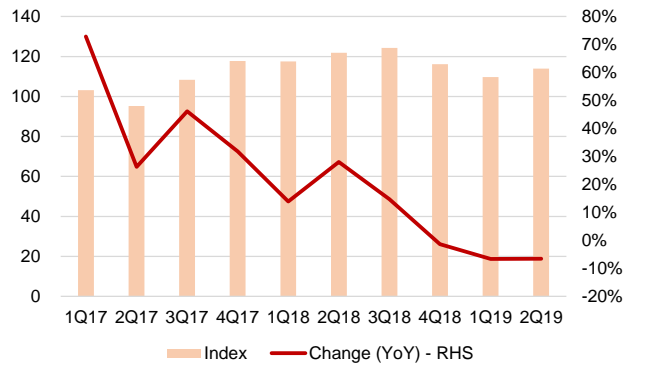
Source: Company data, CMBIS estimates

**Figure 9: China medium-thick steel plate price index**



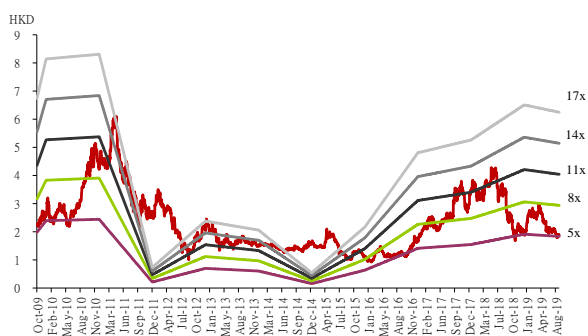
Source: Wind, CMBIS

**Figure 10: China medium thick plate quarterly pricing**



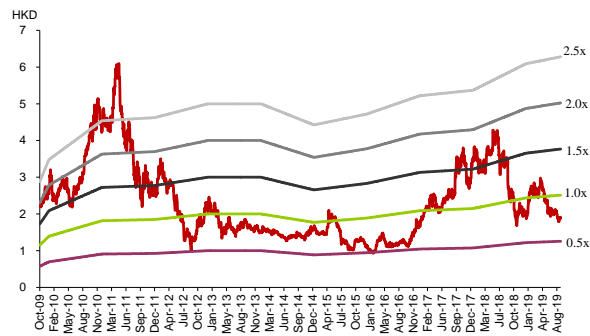
Source: Wind, CMBIS

**Figure 11: Lonking's P/E band**



Source: Bloomberg, Company data, CMBIS estimates

**Figure 12: Lonking P/B band**



Source: Bloomberg, Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Total revenue</b>	<b>8,994</b>	<b>11,868</b>	<b>12,232</b>	<b>12,413</b>	<b>12,569</b>
Cost of sales	(6,603)	(9,144)	(9,357)	(9,543)	(9,687)
<b>Gross profit</b>	<b>2,392</b>	<b>2,725</b>	<b>2,875</b>	<b>2,870</b>	<b>2,883</b>
Other income	42	83	61	62	63
Other gains and losses	38	(159)	159	0	0
S&D expenses	(490)	(640)	(636)	(645)	(654)
Administrative expenses	(227)	(233)	(220)	(223)	(226)
R&D costs	(382)	(545)	(587)	(596)	(603)
Other expenses	(11)	(1)	(24)	(12)	(13)
<b>EBIT</b>	<b>1,361</b>	<b>1,230</b>	<b>1,627</b>	<b>1,455</b>	<b>1,450</b>
Net finance income	63	89	101	99	115
Finance income	110	136	143	141	157
Finance expenses	(47)	(47)	(42)	(42)	(42)
Profit of JV & associates	0	0	0	0	0
<b>Pretax profit</b>	<b>1,424</b>	<b>1,319</b>	<b>1,729</b>	<b>1,554</b>	<b>1,565</b>
Income tax	(378)	(175)	(268)	(241)	(243)
After tax profit	1,046	1,144	1,461	1,313	1,322
MI	(1)	(0)	(1)	(1)	(1)
<b>Net profit</b>	<b>1,046</b>	<b>1,144</b>	<b>1,459</b>	<b>1,312</b>	<b>1,321</b>
<b>Core net profit</b>	<b>907</b>	<b>1,337</b>	<b>1,298</b>	<b>1,312</b>	<b>1,321</b>
D&A	359	353	337	347	357
<b>EBITDA</b>	<b>1,720</b>	<b>1,583</b>	<b>1,964</b>	<b>1,802</b>	<b>1,807</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Pretax profit</b>	<b>1,424</b>	<b>1,319</b>	<b>1,729</b>	<b>1,554</b>	<b>1,565</b>
Finance cost	47	47	42	42	42
Interest income	(110)	(136)	(143)	(141)	(157)
Impairment of trade and other receivables	98	(43)	0	0	0
Write off of inventories	5	(0)	0	0	0
Depreciation and amortisation	359	353	337	347	357
Interest received	27	89	143	141	157
Income tax paid	(280)	(410)	(268)	(241)	(243)
Change in working capital	207	(604)	42	(212)	97
Others	(187)	197	0	0	0
<b>Cash flow from operation</b>	<b>1,592</b>	<b>811</b>	<b>1,882</b>	<b>1,490</b>	<b>1,818</b>
Net capex on PP&E	(136)	(320)	(200)	(200)	(200)
Investment in JV/associates	0	0	0	0	0
Interest received	217	22	0	0	0
Others	(1,492)	740	0	0	0
<b>Cash flow from investing</b>	<b>(1,411)</b>	<b>442</b>	<b>(200)</b>	<b>(200)</b>	<b>(200)</b>
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	(539)	(285)	0	0	0
Dividend paid	(235)	(549)	(731)	(934)	(840)
Interest paid	(50)	(46)	(42)	(42)	(42)
Others	1,144	558	0	0	0
<b>Cash flow from financing</b>	<b>320</b>	<b>(322)</b>	<b>(773)</b>	<b>(976)</b>	<b>(881)</b>
Change in cash	501	931	909	314	737
Cash at beginning of the year	1,131	1,634	2,565	3,474	3,788
Exchange and others	2	1	0	0	0
Cash at the end of the year	1,634	2,565	3,474	3,788	4,525

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>3,004</b>	<b>3,832</b>	<b>3,695</b>	<b>3,548</b>	<b>3,391</b>
PP&E	2,279	2,189	2,052	1,905	1,748
Prepaid land lease payments	180	176	176	176	176
Prepayments for PP&E	33	65	65	65	65
Long term receivables	158	160	160	160	160
Others	3	202	202	202	202
Deferred tax assets	352	384	384	384	384
Pledged deposits	0	656	656	656	656
<b>Current assets</b>	<b>10,815</b>	<b>10,240</b>	<b>10,501</b>	<b>11,761</b>	<b>11,766</b>
Inventories	2,446	2,858	2,577	3,018	2,661
Finance lease receivables	37	21	21	21	21
Trade and bills receivables	1,970	2,529	2,162	2,667	2,292
Prepayments, deposits and other receivables	749	508	508	508	508
Other current assets (loans and receivables)	212	0	0	0	0
AFS investments	2,078	0	0	0	0
Others	225	1,347	1,347	1,347	1,347
Pledged deposits	1,465	411	411	411	411
Cash	1,634	2,565	3,474	3,788	4,525
<b>Current liabilities</b>	<b>5,987</b>	<b>4,479</b>	<b>3,873</b>	<b>4,606</b>	<b>3,971</b>
Trade and bills payables	3,331	3,507	2,902	3,635	3,000
Other payables and accruals	826	713	713	713	713
Bank borrowings	1,503	0	0	0	0
Tax payable	211	124	124	124	124
Others	116	135	135	135	135
<b>Non-current liabilities</b>	<b>102</b>	<b>1,387</b>	<b>1,387</b>	<b>1,387</b>	<b>1,387</b>
Bank borrowings	0	1,287	1,287	1,287	1,287
Deferred tax liabilities	72	63	63	63	63
Others	30	37	37	37	37
<b>Equity</b>	<b>7,730</b>	<b>8,207</b>	<b>8,937</b>	<b>9,316</b>	<b>9,799</b>
Shareholders' equity	7,728	8,205	8,933	9,311	9,792
MI	2	3	4	5	7

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Wheel loaders	54	52	52	51	50
Excavators	15	18	17	17	17
Road rollers	1	1	1	1	1
Forklifts	20	19	20	21	21
Others	10	10	10	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	26.6	23.0	23.5	23.1	22.9
EBITDA margin	19.1	13.3	16.1	14.5	14.4
EBIT margin	15.1	10.4	13.3	11.7	11.5
Net profit margin	11.6	9.6	11.9	10.6	10.5
<b>Growth (%)</b>					
Revenue	75	32	3	1	1
Gross profit	92	14	6	0	0
EBITDA	90	-8	24	-8	0
EBIT	163	-10	32	-11	0
Net profit	126	9	28	-10	1
Core net profit	258	47	-3	1	1
<b>Balance sheet ratio</b>					
Current ratio (x)	2.3	3.1	3.7	3.3	3.8
Receivable turnover days	68	69	70	71	72
Inventory turnover days	109	106	106	107	107
Payable turnover days	134	136	125	125	125
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Profitability (%)</b>					
ROA	8.4	8.2	10.3	8.9	8.7
ROE	14.5	14.4	17.0	14.4	13.8
<b>Per share data</b>					
EPS (RMB)	0.24	0.27	0.34	0.31	0.31
BVPS (RMB)	1.81	1.92	2.09	2.18	2.29
DPS (RMB)	0.13	0.17	0.22	0.20	0.20

Source: Company data, CMBIS estimates

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