

Lonking (3339 HK)

Weak core profit but downside protected by 12% yield

While Lonking's reported net profit in 2019 surged 44% YoY to RMB1.64bn, it was mainly driven by investment gains on wealth management products. Adjusted for these fair value changes, we calculate that the core net profit dropped 5% YoY to RMB1.27bn, 2% below our forecast. The weak core profit was due to the sluggish revenue (-1% YoY), which has been our concern since early last year. We see a lack of growth driver as wheel loader (Lonking's key product), is faced with the threat of small-size excavators. We trimmed our 2020E-21E earnings forecasts by 3-6%. That said, the current price implies ~12% dividend yield (59% payout ratio in 2019), which should offer downside protection. We reset our TP at HK\$2.30, based on 7x 2020E P/E. Maintain **HOLD**.

- Reported net profit in 2019 distorted by fair value change.** Lonking's reported net profit of RMB1.64bn in 2019 included a net fair value gain of ~RMB366mn, while the net profit in 2018 included a net loss of ~RMB238mn. This is the key reason for the high reported net profit growth in 2019. Adjusted for this and other non-recurring items, the core net profit would drop 5% YoY. In 2H19, core profit dropped 9% YoY.
- Lack of revenue growth a key concern.** Revenue in 2019 dropped 1% YoY to RMB11.7bn, implying 4.5% YoY decline in 2H19, largely due to a similar rate of decline in wheel loader sales. On the positive side, gross margin improved to 24.9% in 2H19, up from 22.6% / 23.2% in 2H18 / 1H19 respectively, which we believe was helped by lower steel cost. SG&A ratio was largely stable.
- Strong balance sheet and cash flow to support dividend payout and valuation.** Operating cash inflow surged 93% YoY to RMB1.57bn in 2019, implying strong cash generating capability. With proposed dividend payment of RMB976mn, payout ratio reached 59% based on the reported net profit. On the other hand, as at end-2019, Lonking's net cash and financial investment amounted to RMB4.3bn, which represented ~50% of the current market cap.
- Upside risks:** (1) strong recovery of wheel loader sales; (2) a potential target of acquisition/privatization. **Downside risks:** (1) slow recovery of construction activities; (2) substitution risk of wheel loader; (3) investment loss.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	11,868	11,744	12,034	12,104	12,155
YoY growth (%)	32.0	-1.0	2.5	0.6	0.4
Net income (RMB mn)	1,144	1,643	1,271	1,249	1,302
EPS (RMB)	0.267	0.384	0.297	0.292	0.304
YoY growth (%)	9.4	43.7	-22.7	-1.7	4.3
Consensus (RMB)	n/a	n/a	0.330	0.304	0.299
EV / EBITDA (x)	3.6	2.6	3.3	3.3	3.3
P/E (x)	7.2	5.1	6.6	6.7	6.4
P/B (x)	1.0	0.9	0.9	0.9	0.8
Yield (%)	8.9	11.7	9.9	9.7	10.2
ROE (%)	14.4	19.0	13.8	13.0	13.0
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price	HK\$2.30
(Previous TP)	HK\$1.90)
Up/Downside	+6%
Current Price	HK\$2.16

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Stock Data

Mkt Cap (HK\$ mn)	9,245
Avg 3 mths t/o (HK\$ mn)	15
52w High/Low (HK\$)	2.73/1.79
Total Issued Shares (mn)	4,280

Source: Bloomberg

Shareholding Structure

Li San Yim	56.0%
GIC	7.0%
Others	37.0%

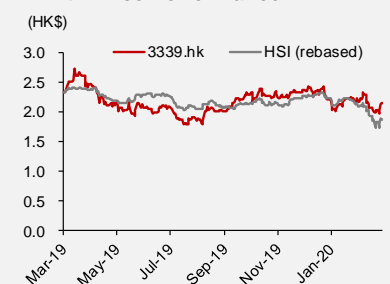
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	+0.9%	-12.5%
3-mth	-7.3%	-16.2%
6-mth	+7.5%	-10.3%

Source: Bloomberg

12-mth Price Performance



Source: Wind

Auditor: Ernst & Young

Related Reports

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- China Construction Machinery Sector - Scenario analysis on the resumption of factory production – 10 Feb 2020
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■ **Valuation not demanding but lacks catalyst.** Lonking's share price has been relatively resilient amid the volatile market, which we believe was due to the solid financial position and low valuation. We see Lonking a value play but lacks growth potential. We reset our TP as HK\$2.3, based on 7x 2020E P/E, representing the average P/E since 2016 (the start of the upcycle). Our previous TP of HK\$1.9 was based on 5x 2019E P/E, historical trough multiple.

Figure 1: Highlight on 2019 results

	2018	2019	Change (YoY)	2019E	A vs E	1H18	1H19	Change (YoY)	2H18	2H19	Change (YoY)
Revenue (RMB mn)											
Wheel loaders	6,154	6,026	-2.1%	6,302	-4.4%	3,337	3,337	0.0%	2,817	2,689	-4.6%
Excavators	2,111	2,122	0.5%	2,118	0.2%	1,379	1,408	2.1%	733	714	-2.5%
Road rollers	159	113	-28.7%	139	-18.4%	86	72	-15.7%	73	41	-44.0%
Forklifts	2,308	2,374	2.8%	2,461	-3.5%	1,292	1,351	4.6%	1,017	1,023	0.6%
Others	1,132	1,107	-2.3%	1,209	-8.5%	553	590	6.6%	579	517	-10.7%
Subtotal for construction machinery	11,865	11,742	-1.0%	12,229	-4.0%	6,646	6,758	1.7%	5,219	4,983	-4.5%
Finance lease interest income	3	2	-36.7%	3	-29.7%	2	1	-33.2%	2	1	-40.8%
Total revenue	11,868	11,744	-1.0%	12,232	-4.0%	6,648	6,760	1.7%	5,220	4,984	-4.5%
Cost of sales	-9,144	-8,933	-2.3%	-9,357	-4.5%	-5,106	-5,188	1.6%	-4,038	-3,744	-7.3%
Gross profit	2,725	2,811	3.2%	2,875	-2.2%	1,542	1,571	1.9%	1,182	1,240	4.9%
Other income	83	102	23.1%	61	67.0%	12	29	132.6%	71	73	4.0%
Other gains and losses	-159	350	n/a	159	120.2%	-45	145	n/a	-114	205	n/a
S&D expenses	-640	-624	-2.5%	-636	-2.0%	-342	-337	-1.4%	-298	-287	-3.7%
Administrative expenses	-233	-238	2.0%	-220	8.2%	-125	-122	-2.7%	-109	-117	7.5%
R&D costs	-545	-550	1.0%	-587	-6.3%	-265	-288	8.9%	-280	-262	-6.4%
Other expenses	-1	-11	n/a	-24	-54.8%	-1	-10	n/a	0	-1	n/a
EBIT	1,230	1,840	49.6%	1,627	13.1%	777	988	27.1%	453	853	88.1%
Net finance income/(expense)	89	125	40.5%	101	23.3%	48	60	26.5%	41	65	56.7%
Finance income	136	165	21.7%	143	15.5%	66	85	28.6%	69	80	15.1%
Finance expenses	-47	-40	-14.1%	-42	-3.5%	-19	-25	33.9%	-28	-15	-46.2%
Share of profit of JV and associates	0	0	n/a	0	n/a	0	0	n/a	0	0	n/a
Pretax profit	1,319	1,965	49.0%	1,729	13.7%	825	1,048	27.1%	495	917	85.5%
Income tax	-175	-321	83.4%	-268	20.0%	-121	-159	32.0%	-55	-162	197.2%
After tax profit	1,144	1,644	43.7%	1,461	12.5%	704	889	26.3%	440	755	71.6%
M	-0	-1	-456.3%	-1	-63.4%	-0	-0	239.5%	-0	-0	n/a
Net profit	1,144	1,643	43.7%	1,459	12.6%	704	889	26.2%	440	755	71.5%
Core net profit	1,337	1,272	-4.9%	1,298	-2.0%	740	727	-1.7%	597	544	-8.8%
D&A	353	349	-1.0%	337	3.6%	175	177	1.2%	178	172	-3.2%
EBITDA	1,583	2,190	38.3%	1,964	11.5%	952	1,165	22.4%	631	1,025	62.3%

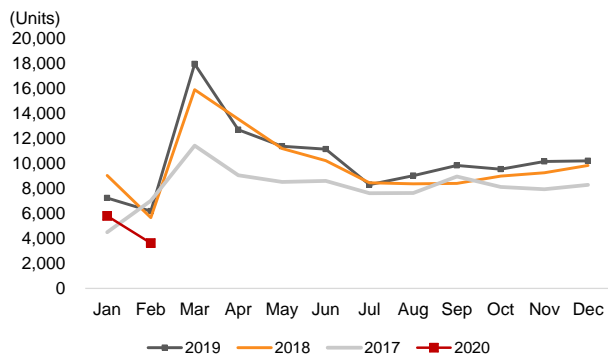
Source: Company data, CMBIS

Figure 2: Key changes in assumptions

Change in key assumptions	Old		New		Change	
	2020E	2021E	2020E	2021E	2020E	2021E
Revenue (RMB mn)						
Wheel loaders	6,331	6,301	6,080	5,991	-4.0%	-4.9%
Excavators	2,111	2,154	2,091	2,112	-1.0%	-1.9%
Road rollers	139	142	139	142	0.0%	0.0%
Forklifts	2,560	2,636	2,560	2,636	0.0%	0.0%
Others	1,270	1,333	1,162	1,220	-8.5%	-8.5%
Subtotal for construction machinery	12,410	12,566	12,031	12,101	-3.1%	-3.7%
Finance lease interest income	3	3	2	2	-29.7%	-28.3%
Total revenue	12,413	12,569	12,034	12,104	-3.1%	-3.7%
Gross margin					<i>ppt</i>	<i>ppt</i>
Wheel loaders	29.0%	28.5%	29.0%	28.5%	0.0	0.0
Excavators	20.0%	21.0%	21.5%	21.5%	1.5	0.5
Road rollers	15.8%	15.8%	15.8%	15.8%	0.0	0.0
Forklifts	14.0%	14.0%	14.0%	14.0%	0.0	0.0

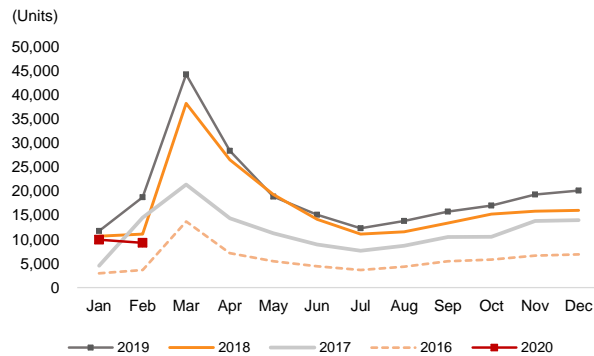
Source: Company data, CMBIS

Figure 3: China's wheel loader monthly sales



Source: CCMA, CMBIS

Figure 4: China's excavator monthly sales



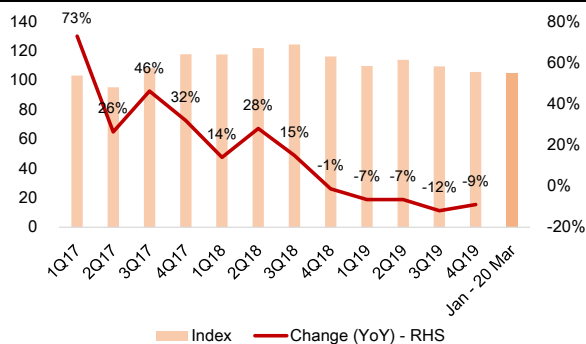
Source: CCMA, CMBIS

Figure 5: China medium-thick steel plate price index



Source: Wind, CMBIS

Figure 6: China medium think plate quarterly pricing



Source: Wind, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	11,868	11,744	12,034	12,104	12,155
Cost of sales	-9,144	-8,933	-9,229	-9,329	-9,379
Gross profit	2,725	2,811	2,804	2,775	2,776
Other income	83	102	60	61	61
Other gains and losses	-159	350	0	0	0
S&D expenses	-640	-624	-638	-641	-632
Administrative expenses	-233	-238	-241	-242	-219
R&D costs	-545	-550	-578	-581	-583
Other expenses	-1	-11	-12	-12	-12
EBIT	1,230	1,840	1,396	1,359	1,390
Net finance income	89	125	127	138	171
Finance income	136	165	152	163	196
Finance expenses	-47	-40	-25	-25	-25
Profit of JV & associates	0	0	0	0	0
Pretax profit	1,319	1,965	1,523	1,497	1,561
Income tax	-175	-321	-251	-247	-258
After tax profit	1,144	1,644	1,272	1,250	1,304
MI	-0	-1	-1	-1	-1
Net profit	1,144	1,643	1,271	1,249	1,302
Core net profit	1,337	1,272	1,271	1,249	1,302
D&A	353	349	354	364	369
EBITDA	1,583	2,190	1,750	1,722	1,759

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	1,319	1,965	1,523	1,497	1,561
Finance cost	47	40	25	25	25
Interest income	-136	-165	-152	-163	-196
Impairment of trade and other receivables	-43	0	0	0	0
Write off of inventories	-0	0	0	0	0
Depreciation and amortisation	353	349	354	364	369
Interest received	89	165	152	163	196
Income tax paid	-410	-321	-251	-247	-258
Change in working capital	-604	279	-480	-92	126
Others	197	-742	0	0	0
Cash flow from operation	811	1,571	1,170	1,546	1,824
Net capex on PP&E	-320	-301	-200	-200	-100
Investment in JV/associates	0	0	0	0	0
Interest received	22	0	0	0	0
Others	740	-369	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	-578	0	0	0
Dividend paid	-549	-731	-976	-826	-812
Interest paid	-46	-40	-25	-25	-25
Others	558	385	0	0	0
Cash flow from financing	-322	-964	-1,000	-851	-836
Change in cash	931	-63	-30	496	887
Cash at beginning of the year	1,634	2,565	2,502	2,472	2,967
Exchange and others	1	-0	0	0	0
Cash at the end of the year	2,565	2,502	2,472	2,967	3,855

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	3,832	3,788	3,634	3,470	3,202
PP&E	2,189	2,081	1,927	1,764	1,495
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	11,312	11,844	12,751
Inventories	2,858	3,006	3,063	3,327	3,097
Finance lease receivables	21	10	10	10	10
Trade and bills receivables	2,529	2,245	2,700	2,473	2,722
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	2,472	2,967	3,855
Current liabilities	4,479	4,741	4,774	4,718	4,864
Trade and bills payables	3,507	3,650	3,683	3,627	3,773
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	9,373	9,797	10,289
Shareholders' equity	8,205	9,074	9,370	9,792	10,283
MI	3	3	4	5	6

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Wheel loaders	52	51	51	49	49
Excavators	18	18	17	17	17
Road rollers	1	1	1	1	1
Forklifts	19	20	21	22	22
Others	10	9	10	10	11
Finance lease interest income	0	0	0	0	0
Total	100	100	100	100	100
Profit & loss ratio (%)					
Gross margin	23.0	23.9	23.3	22.9	22.8
EBITDA margin	13.3	18.6	14.5	14.2	14.5
EBIT margin	10.4	15.7	11.6	11.2	11.4
Net profit margin	9.6	14.0	10.6	10.3	10.7
Growth (%)					
Revenue	32	-1	2	1	0
Gross profit	14	3	0	-1	0
EBITDA	-8	38	-20	-2	2
EBIT	-10	50	-24	-3	2
Net profit	9	44	-23	-2	4
Core net profit	47	-5	0	-2	4
Balance sheet ratio					
Current ratio (x)	3.1	3.1	3.1	3.2	3.3
Receivable turnover days	69	74	75	78	78
Inventory turnover days	106	120	120	125	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	8.6	8.3	8.3
ROE	14.4	19.0	13.8	13.0	13.0
Per share data					
EPS (RMB)	0.27	0.38	0.30	0.29	0.30
BVPS (RMB)	1.92	2.12	2.19	2.29	2.40
DPS (RMB)	0.17	0.23	0.19	0.19	0.20

Source: Company data, CMBIS estimates

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