

China Construction Machinery

Implications of 1H19 results and upcoming drivers

Construction machinery and HDT manufactures generally reported decent results in 1H19. Large construction machinery players such as **Zoomlion (1157 HK / 000157 CH, BUY)**, **SANY Heavy (600031 CH, NR)** and **XCMG (000425 CH, NR)** reported significant net profit growth (100-200% YoY). Going forward, we believe the launch of new products, market consolidation, environmental policies driven replacement demand and import substitution will serve as growth drivers. In the near term, the post result remarks by major construction machinery players point to a recovery of order intakes in Sep. We believe a potential pick up of infrastructure spending will boost sales volume in 4Q19E.

- **Larger players reported better revenue growth in 1H19.** The trend of industry consolidation continued with large players such as SANY Heavy and Zoomlion reported >50% YoY growth of revenue. The growth was driven by strong demand for crane and concrete machinery, as well as market share gains by both players. Smaller players such as **Liugong (000528 CH, NR)** and **Lonking (3339 HK, HOLD)** with a focus on wheel loaders reported low single digit revenue growth due to the substitution by excavator.
- **Margin expansion.** Majority of the players reported margin expansion in 1H19, on the back of operating leverage and product mix enhancement. Zoomlion and **SANY Int'l (631 HK, BUY)** reported 4.5ppt and 3.6ppt YoY expansion on gross margin. We expect both companies will continue to see margin upside with the launch of more products.
- **R&D spending on the rise.** Major players raised their R&D expense ratio in 1H19. We believe this is a major trend going forward as the adoption of advanced manufacturing process to reduce cost and the capability to offer intelligent products will become critical factors of success going forward. In 1H19, **Weichai (2338 HK, BUY)** spent RMB2.4bn on R&D expense, the highest among all players. In terms of growth, SANY Heavy's R&D expense surged 1.8x YoY. In terms of expense ratio, SANY Int'l raised its R&D expense ratio by 3ppt to 6.9%.
- **Operating cash flow surprisingly strong.** It is surprising that most of the players reported significant improvement in operating cash flow. This suggested that apart from pursuing volume growth, the machinery manufacturers maintained a prudent approach and put considerable effort on cash collection. The strong cash operating cash flow suggested high earnings quality in general.
- **Sector outlook:** Major players expect strict environmental policies to eliminate old models and the implementation of strict National Emission Standard (NES) for the new sales will continue to support the replacement demand. On the other hand, import substitution will serve as growth driver for the component makers. For example, **Jiangsu Hengli (601100 CH, NR)** is on a good track to boost its sales of hydraulic pump & valves. Weichai is targeting the large bore engine for the industrial power segment. Both areas are currently dominated by the overseas players.

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3. Weichai Power (2338 HK, BUY) – 2Q19 earnings +9% YoY; within expectation – 30 Aug 2019
4. Jiangsu Hengli (601100 CH, NR) – 2Q19 earnings slowed but in line with estimate – 27 Aug 2019

Figure 1: 1H19 results at a glance

	SANY Heavy	Zoomlion	XCMG	Liugong	Hengli	Dingli	SANY Int'l	Weichai	Sinotruk	Lonking
(RMB mn)										
Revenue										
1H19	43,386	22,262	31,156	10,131	2,793	849	3,044	90,862	34,492	6,760
1H18	28,124	14,706	23,944	9,754	2,164	785	2,196	82,264	33,624	6,648
Change (YoY)	54.3%	51.4%	30.1%	3.9%	29.0%	8.1%	38.6%	10.5%	2.6%	1.7%
Gross margin										
1H19	32.4%	30.0%	18.3%	23.1%	37.0%	41.7%	31.0%	21.7%	19.5%	23.2%
1H18	31.6%	25.5%	17.3%	23.0%	34.6%	38.6%	27.4%	21.8%	18.1%	23.2%
Change ppt (YoY)	0.7	4.5	1.0	0.1	2.4	3.1	3.6	(0.0)	1.5	0.0
Net profit										
1H19	6,748	2,585	2,283	661	671	260	552	5,287	2,493	889
1H18	3,389	874	1,104	596	463	205	358	4,393	2,365	704
Change (YoY)	99.1%	195.8%	106.8%	10.9%	44.7%	26.7%	54.1%	20.4%	5.4%	26.2%
Operating cash flow										
1H19	7,595	3,298	2,841	1,176	795	57	516	5,426	4,012	850
1H18	6,221	1,405	1,946	(370)	192	66	67	8,513	516	230
Change (YoY)	22.1%	134.7%	46.0%	n/a	313.4%	-13.9%	672.0%	-36.3%	677.5%	270.3%
R&D expense										
1H19	1,189	461	1,078	231	117	26	209	2,398	n/a	288
1H18	420	197	1,074	204	80	18	85	1,751	n/a	265
Change (YoY)	182.9%	134.0%	0.4%	13.4%	46.2%	44.3%	145.6%	36.9%	n/a	8.9%
R&D exp as % of revenue										
1H19	2.7%	2.1%	3.5%	2.3%	4.2%	3.0%	6.9%	2.6%	n/a	4.3%
1H18	1.5%	1.3%	4.5%	2.1%	3.7%	2.3%	3.9%	2.1%	n/a	4.0%
Change ppt (YoY)	1.2	0.7	(1.0)	0.2	0.5	0.8	3.0	0.5	n/a	0.3

Note: Lonking's net profit growth in 1H19 was driven mainly by investment gain. Core Profit was down 2% YoY based on our calculation.

Source: Company data, CMBIS

Figure 2: Timetable for the implementation of National Emission Standard

		Year																					
Type of vehicles		00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18	19	20	21
Heavy duty vehicle	Diesel																						
	Gasoline																						
	Gas fueled																						
Light duty vehicle	Diesel																						
	Gasoline																						
	Gas fueled																						
Off road vehicle	Diesel																						

National emission standard ■ No regulation ■ I ■ II ■ III ■ IV ■ V ■ VI

Source: Ministry of Ecology and Environmental, CMBIS

Figure 3: Peers comparison

Ticker	Company	Rating	Price (local currency)	TP (local currency)	Upside/ (downside)	Market cap (US\$ mn)	PE (x)		PB (x)		EV/EBITDA (x)		Dividend yield (%)	
							FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
HK listed														
631 HK Equity	SANY INTERNATIONAL	BUY	3.45	4.72	37%	1,369	10.4	8.6	1.3	1.2	6.4	5.3	2.9	3.5
3339 HK Equity	LONKING	HOLD	2.05	1.90	-7%	1,124	5.4	6.0	0.9	0.8	2.3	2.5	11.8	10.6
1157 HK Equity	ZOOMLION HEAVY-H	BUY	5.48	6.95	27%	6,373	9.4	8.2	0.9	0.9	7.0	6.4	9.6	10.9
2338 HK Equity	WEICHAI POWER-H	BUY	12.84	16.20	26%	13,557	9.3	8.9	2.0	1.8	4.6	4.5	5.9	6.2
3808 HK Equity	SINOTRUK HK LTD	BUY	11.84	19.40	64%	4,186	6.3	5.8	1.0	0.9	2.6	2.4	5.5	6.0
564 HK Equity	ZHENGZHOU COAL-H	NR	4.08	-	-	1,665	6.0	5.1	0.6	0.5	5.0	4.3	3.8	4.9
	HK listed average						7.8	7.1	1.1	1.0	4.7	4.3	6.6	7.0
A share														
603338 CH Equity	ZHEJIANG DINGLI -A	BUY	57.66	72.00	25%	2,902	33.3	24.1	6.4	5.2	28.1	19.7	0.5	0.7
600031 CH Equity	SANY HEAVY IND-A	NR	14.75	-	-	17,920	11.3	10.1	3.0	2.4	8.3	7.4	2.9	3.2
000425 CH Equity	XCMG CONSTRUCT-A	NR	4.72	-	-	5,367	10.5	8.6	1.2	1.1	9.9	8.6	2.1	2.7
000157 CH Equity	ZOOMLION HEAVY-A	BUY	5.95	6.70	13%	6,541	11.5	10.1	1.2	1.1	8.7	7.9	7.8	8.9
000528 CH Equity	GUANGXI LIUGON-A	NR	6.61	-	-	1,416	8.7	8.2	0.9	0.9	9.4	8.7	3.9	4.2
600815 CH Equity	XIAMEN XGMA-A	NR	3.05	-	-	425	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
600761 CH Equity	ANHUI HELI CO-A	NR	9.83	-	-	1,056	11.7	10.5	1.5	1.4	5.4	4.9	4.4	4.9
603298 CH Equity	HANGCHA GROUP-A	NR	12.36	-	-	1,110	11.7	9.9	1.7	1.5	6.5	5.4	3.1	3.9
000338 CH Equity	WEICHAI POWER-A	NR	12.23	-	-	13,913	10.1	9.6	2.2	2.0	5.0	4.9	5.5	5.8
000951 CH Equity	CNHTC JINAN T-A	NR	15.63	-	-	1,522	8.8	7.9	1.6	1.4	7.1	6.3	5.2	5.6
601100 CH Equity	JIANGSU HENGLI-A	NR	36.48	-	-	4,670	26.7	21.5	5.8	4.8	18.8	15.5	1.2	1.5
601717 CH Equity	ZHENGZHOU COAL-A	NR	7.30	-	-	1,708	12.1	10.4	1.2	0.9	10.1	8.8	1.9	2.4
600582 CH Equity	TIAN DI -A	NR	3.48	-	-	2,090	11.6	9.7	0.9	0.8	8.0	6.8	1.7	2.3
002526 CH Equity	SHANDONG MININ-A	NR	2.42	-	-	626	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
002691 CH Equity	JIKA EQUIP MA-A	NR	6.65	-	-	328	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	A-share average						12.2	10.6	1.9	1.7	8.8	7.8	3.6	4.1
Overseas														
CAT US Equity	CATERPILLAR INC	NR	133.1	-	-	74,875	11.3	10.8	4.8	4.5	6.6	6.8	2.8	3.1
6305 JP Equity	HITACHI CONST MA	NR	2,608.0	-	-	5,221	9.2	8.9	1.1	1.0	6.7	6.6	3.6	3.8
6301 JP Equity	KOMATSU LTD	NR	2,490.0	-	-	22,538	10.5	10.4	1.2	1.1	6.9	6.8	4.5	4.5
042670 KS Equity	DOOSAN INFRACORE	NR	6,340.0	-	-	1,140	4.6	4.3	0.6	0.5	6.0	5.9	0.0	0.0
Overseas (AWP players)														
TEX US Equity	TEREX CORP	NR	28.0	-	-	1,993	7.8	8.1	2.1	1.8	6.7	6.9	1.5	1.6
OSK US Equity	OSHKOSH CORP	NR	77.3	-	-	5,286	9.6	10.0	2.0	1.8	6.6	7.1	1.4	1.5
LNR CN Equity	LINAMAR CORP	NR	42.8	-	-	2,118	5.3	5.5	n/a	n/a	4.2	4.3	1.1	1.1
PIG FP Equity	HAULOTTE GROUP	NR	7.0	-	-	250	7.3	6.9	0.8	0.7	5.9	5.6	3.8	4.1
6345 JP Equity	AICHI CORP	NR	718.0	-	-	531	10.7	11.4	0.8	0.8	5.5	6.1	3.1	3.2
	Overseas average						8.5	8.5	1.7	1.5	6.1	6.2	2.4	2.6

Source: Company data, Bloomberg, CMBIS estimates

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