

# China Heavy-duty Truck Sector

## Higher certainty driven by strong policy momentum

**OUTPERFORM**  
(Maintain)

We remain positive on heavy-duty truck (HDT) sector as: (1) abundant funding from the issuance of local government bonds will continue to drive demand for construction trucks; (2) anti-illegal truck operation will further speed up the replacement cycle, offering support to the truck demand between 2020E-22E; (3) strong policy support to remove NES III trucks with certain regions starting to phase-out NES IV trucks. We revise up our HDT sales projection by 13% in 2020E and 8-10% in 2021E-22E. Maintain **BUY** rating on **Weichai (2338 HK, TP: HK\$19.2 / 000338 CH, TP: RMB16.8)** and **Sinotruk (3808 HK, TP: HK\$28.3)**.

- **Abundant funding to provide solid support to the HDT demand throughout the year.** The amount of local government bond issued surged 1.1x YoY to RMB1.2tn in Aug, taking the total amount to RMB4.96tn in 8M20 (+25% YoY). Excluding bonds for refinancing, the amount of new bond issuance reached RMB3.75tn in 8M20. While the spending in indemnificatory housing and renovation of shanty area in Jul/Aug reached 40%/23% of the total fund raised (versus a single-digit in 1H20), we expect the proportion will not further increase going forward, as infrastructure construction such as transportation and municipal projects remain the key focus.
- **Anti-illegal truck operation underway.** MIIT released a circular in Jul calling for the crackdown of illegal truck modification with a target to eliminate those illegal trucks by 2022 (<关于开展货车非法改装专项整治工作的通知>). Target vehicles include (1) hazardous goods trucks, (2) dump trucks, (3) semi-trailers, (4) light-duty trucks and (5) concrete mixers. According to the timetable, the operation has just entered the inspection stage (Sep 2020 - Mar 2021). This will trigger a new round of replacement cycle.
- **Strong policy support to remove NES III trucks with certain regions starting to phase-out NES IV trucks.** Key provinces such as Shandong and Henan already set clear targets to phase out a total of ~430k units of NES III trucks. Of this volume, 70% will need to be achieved by end-2020. In Shandong, subsidies will be extended to 2021 (depends on city-level policies) for NES III elimination. Besides, in Hebei, certain cities have already set restriction on the operation of NES IV in some districts. We see rising possibility that the phase-out of NES IV will be accelerated, thereby offering upside to the HDT demand.
- **Higher HDT sales projection.** We revise up our 2020E/21E/22E HDT sales forecast by 13%/9%/10% to 1.54mn/1.38mn/1.40 units. We expect a 24% YoY sales growth in Sep-Dec 2020, after a 35% YoY growth in 8M20, which will take the full year growth to 31% YoY. Due to high base effect, we forecast HDT sales to drop 10% YoY in 2021E and stabilize in 2022E. That said, such sales volume still implies a sizable market and we expect large players to grow through market share gain going forward.
- **Raised TP of Weichai Power.** While we trimmed our 2020E earnings forecast by 5% due mainly to revised margin assumptions, we lifted our 2021E-22E forecast by 3-4% after incorporating our new industry forecast. Our SOTP-based TP is raised to HK\$19.2 (H) /RMB16.8 (A). We believe concerns on margin weakness is already in the price, while strong upcoming HDT sales data points and improvement in 3Q results will serve as near term catalyst.

### China Capital Goods

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### Related Reports

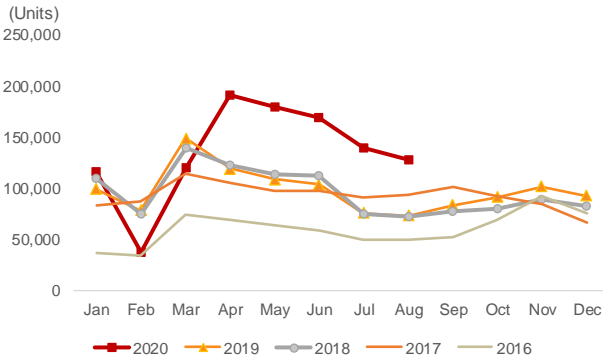
1. Sinotruk (3808 HK, BUY) - Ji'n'an Truck's fund-raising exercise a long term positive – 28 Sep 2020
2. Sinotruk (3808 HK, BUY) – Uncover the hidden profitability in 1H20 results – 31 Aug 2020
3. China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020
4. Sinotruk (Hong Kong) (3808 HK, BUY) – Returning to growth territory in 2020E – 2 Apr 2020
5. Weichai Power (2338 HK, BUY) – Correction offers buying opportunity; Diversification strategy on track – 30 Mar 2020
6. China Construction Machinery Sector – Four structural drivers to extend the upcycle to 2020-21E – 27 Nov 2019

**Figure 1: Change in industry HDT sales assumptions**

HDT sales volume	Old	New	Change
(Units 000)			
2020E	1,360	1,539	13.2%
2021E	1,271	1,380	8.6%
2022E	1,275	1,396	9.5%

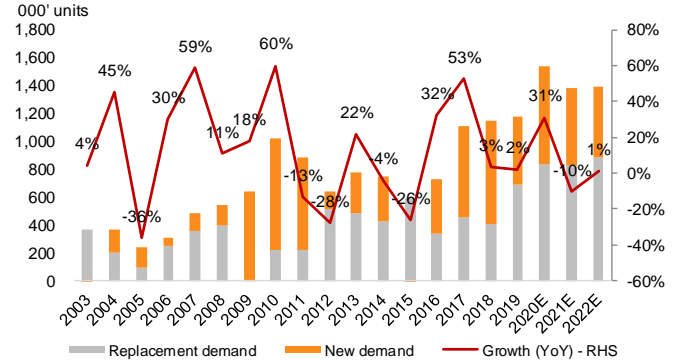
Source: CMBIS estimates

**Figure 2: China HDT sales +35 YoY in 8M20**



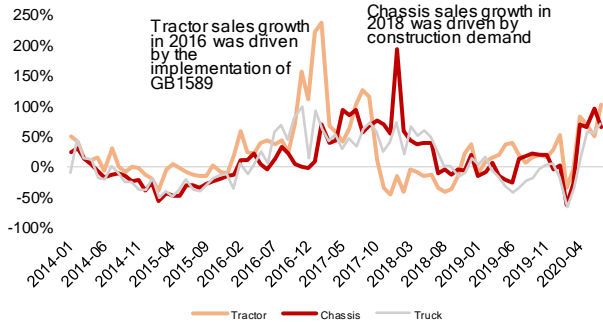
Source: Cvworl, CMBIS

**Figure 3: CMBIS HDT sales projection**



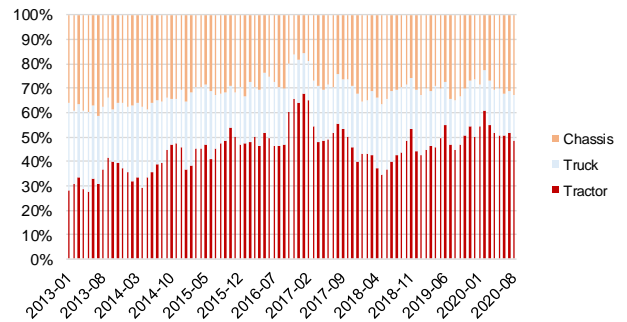
Source: Cvworl, Wind, CMBIS estimates

**Figure 4: China HDT sales growth by type (YoY)**



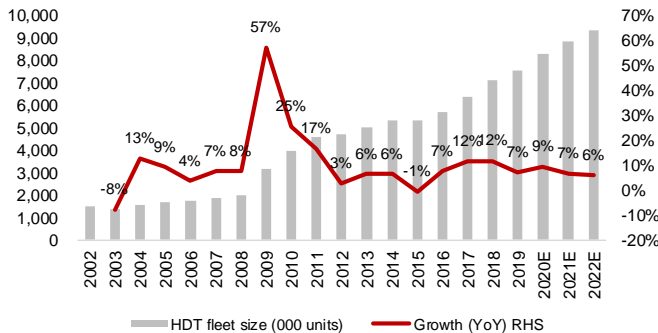
Source: Wind, CMBIS

**Figure 5: China HDT sales breakdown by type**



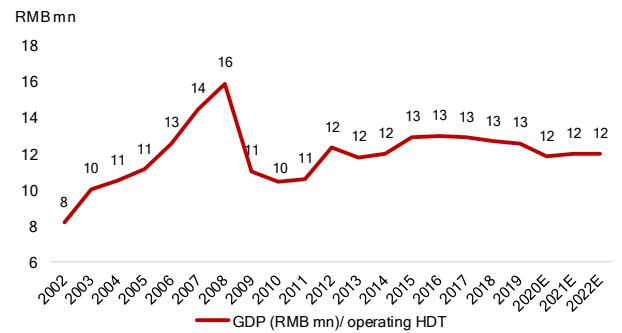
Source: Wind, CMBIS

**Figure 6: China HDT fleet size**



Source: Wind, CMBIS estimates

**Figure 7: GDP per unit of operating HDT**



Source: Wind, CMBIS estimates

**Figure 8: HDT sales in China by company**

		2020							
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
<b>Sales volume (units)</b>									
<b>Company</b>									
FAW	一汽解放	52,540	11,655	25,578	57,539	43,317	38,963	35,858	27,593
Dongfeng	东风	17,285	3,962	22,970	35,974	36,389	34,248	28,122	26,742
CNHTC	中国重汽	13,244	8,737	20,508	25,718	25,233	24,942	19,976	21,238
SXQC	陕汽集团	10,088	3,835	19,933	24,476	25,798	26,460	19,125	20,616
Foton	北汽福田	8,938	3,184	11,581	18,526	18,511	17,180	15,071	12,289
JAC	安徽江淮	3,951	1,415	5,655	5,412	6,524	4,157	4,467	4,954
SAIC-IVECO Hongyan	上汽依维柯红岩	4,007	1,858	5,005	9,018	10,119	9,010	6,510	6,091
Da Yun	成都大运	2,053	739	2,622	3,819	3,029	3,915	2,934	3,338
CAMC	安徽华菱	1,500	922	2,200	2,983	2,353	2,260	1,853	1,820
Others	其他	3,042	1,263	3,928	7,689	7,964	8,152	5,418	5,362
<b>Total</b>		<b>116,648</b>	<b>37,570</b>	<b>119,980</b>	<b>191,154</b>	<b>179,237</b>	<b>169,287</b>	<b>139,334</b>	<b>130,043</b>
<b>Change (YoY)</b>									
<b>Company</b>									
FAW	一汽解放	57%	-43%	-30%	91%	46%	71%	95%	74%
Dongfeng	东风	28%	-70%	-27%	45%	63%	60%	73%	63%
CNHTC	中国重汽	-12%	-35%	-15%	45%	62%	47%	64%	91%
SXQC	陕汽集团	-20%	-70%	-18%	42%	64%	56%	83%	97%
Foton	北汽福田	61%	-45%	0%	111%	164%	137%	179%	112%
JAC	安徽江淮	-10%	-47%	28%	56%	89%	22%	99%	144%
SAIC-IVECO Hongyan	上汽依维柯红岩	-39%	-38%	-9%	47%	102%	77%	59%	52%
Da Yun	成都大运	-18%	-61%	-16%	68%	27%	4%	33%	50%
CAMC	安徽华菱	-30%	-48%	0%	44%	14%	109%	101%	44%
Others	其他	4%	-57%	-29%	28%	62%	65%	50%	34%
<b>Average</b>		<b>18%</b>	<b>-52%</b>	<b>-19%</b>	<b>61%</b>	<b>66%</b>	<b>63%</b>	<b>84%</b>	<b>78%</b>
<b>Market share</b>									
<b>Company</b>									
FAW	一汽解放	45%	31%	21%	30%	24%	23%	26%	21%
Dongfeng	东风	15%	11%	19%	19%	20%	20%	20%	21%
CNHTC	中国重汽	11%	23%	17%	13%	14%	15%	14%	16%
SXQC	陕汽集团	9%	10%	17%	13%	14%	16%	14%	16%
Foton	北汽福田	8%	8%	10%	10%	10%	10%	11%	9%
JAC	安徽江淮	3%	4%	5%	3%	4%	2%	3%	4%
SAIC-IVECO Hongyan	上汽依维柯红岩	3%	5%	4%	5%	6%	5%	5%	5%
Da Yun	成都大运	2%	2%	2%	2%	2%	2%	2%	3%
CAMC	安徽华菱	1%	2%	2%	2%	1%	1%	1%	1%
Others	其他	3%	3%	3%	4%	4%	5%	4%	4%
<b>Total</b>		<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Note: CNHTC is the parent co of Sinotruk. Shaanxi Automobile Group is the second largest shareholder of Shaanxi Heavy-duty Motor with 49% stake. Weichai is the largest shareholder of Shaanxi Heavy-duty Motor with 51% stake.

Source: Wind, CVworld, CMBIS

**Figure 9: Timetable for the implementation of NES**

		Year																							
		00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18	19	20	21	22	23
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(a) ■ VI(b)

Source: Ministry of Ecology and Environmental, CMBIS

**Figure 10: Subsidies for the phase-out of NES III trucks**

Province	City	Subsidies provided (per unit of truck)	
Shandong	Qi'nan	<b>1st stage: Jan-Dec 2020:</b> HDT: RMB16-32k MDT: RMB9.6-16k LDT: RMB5.6-9.6k	<b>2nd stage: Jan-Jun 2021:</b> HDT: RMB14-28k MDT: RMB7-14k LDT: RMB4.9-8.4k
	Qingdao	<b>Eligible until end-Mar 2021</b> MDT-HDT (>8t): RMB25-50k MDT (4.5-8.0t): RMB15-25k LDT (<4.5t): RMB10k-15k	
	Beijing	<b>1st stage: Apr-Dec 2020:</b> Truck: RMB7-14k	<b>2nd stage: Jan-Dec 2021:</b> Truck: RMB5.6-11.2k
Shaanxi		<b>Eligible until end-2020</b> HDT: RMB26k MDT: RMB15k LDT: RMB7k Mini truck: RMB4k Diesel to gas: RMB6k	
Henan	Luoyang	<b>1st stage: Aug 2019-Jun 2020:</b> HDT: RMB2-7k MDT: RMB1.5-5k	<b>2nd stage: Jul-Dec 2020:</b> Reduced by 30% from that in 1st stage Reduced by 30% from that in 1st stage
Hainan	-	<b>Eligible until end-2020</b> HDT: RMB25k MDT: RMB18k LDT: RMB13k Mini truck: RMB7k	
Zhejiang	Rui'an	<b>Apr 2019-Dec 2020</b> HDT: RMB25-37k MDT: RMB17-25k LDT: RMB10-14k	
	Ningbo	<b>Feb 2019-Dec 2020</b> HDT: RMB28-57k MDT: RMB13-22k LDT: RMB6-15k	
	Wenzhou	<b>Eligible until end-2020</b> HDT: RMB25-37k MDT: RMB17-25k LDT: RMB10-14k	
-	Shanghai	<b>Oct 2019 - Dec 2020</b> HDT: RMB22-68k MDT: RMB12-39k LDT: RMB11-35k Mini truck: RMB3-9k	
Jiangsu	Nanjing	<b>Eligible until end-2020</b> HDT: RMB10-38k MDT: RMB6-27k LDT: RMB4-16k	

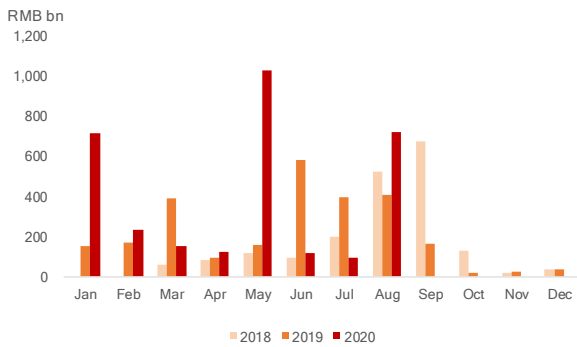
Source: Local government websites, Cvworld, CMBIS

**Figure 11: Timetable for anti-illegal truck operation**

Period	Stage
Jul-Aug 2020	Preparation
Sep 2020 - Mar 2021	Inspection
Apr-May 2021	Summary and proposal
End-2022	To basically eliminate illegal truck modification

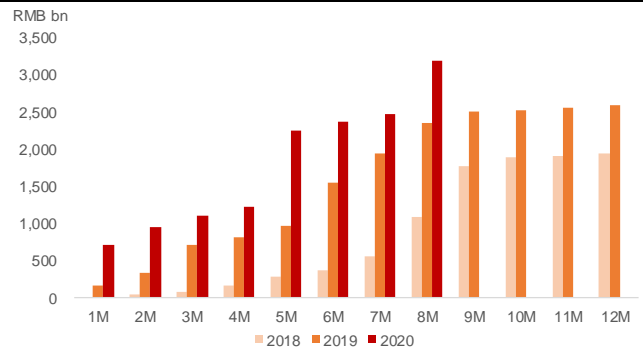
Source: Ministry of Industry and Information Technology &lt;关于开展货车非法改装专项整治工作的通知&gt;, CMBIS

**Figure 12: Local gov't special bond issue amount (monthly)**



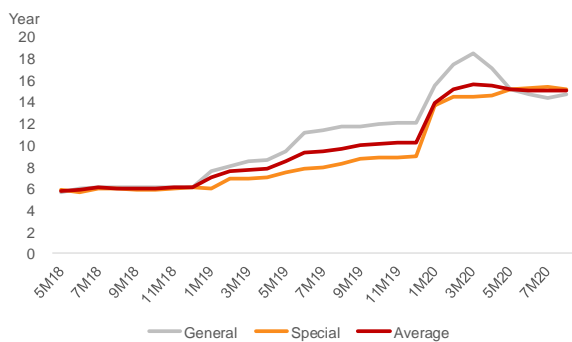
Source: Ministry of Finance, CMBIS

**Figure 13: Local gov't special bond issue amount (YTD)**



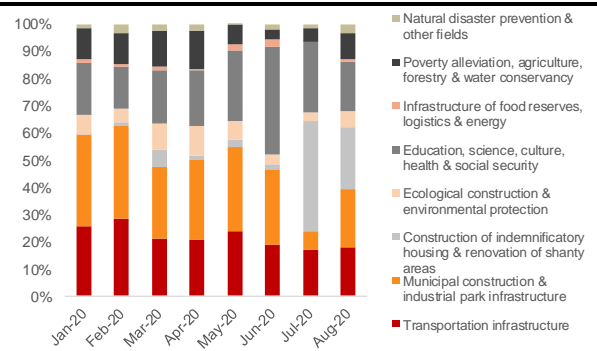
Source: Ministry of Finance, CMBIS

**Figure 14: Rising local gov't bond average duration to match with the long payback period of infrastructure projects**



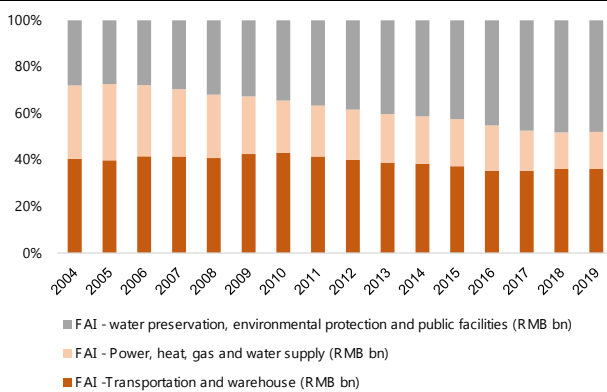
Source: Ministry of Finance, CMBIS

**Figure 15: Investment targets of the newly issued local gov't bonds**



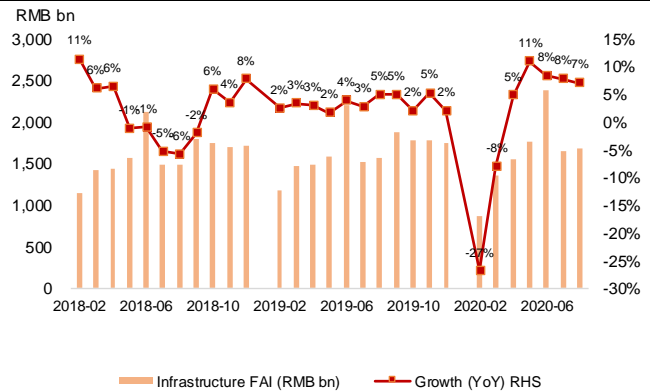
Source: Ministry of Finance, CMBIS estimates

**Figure 16: Breakdown of infrastructure FAI**



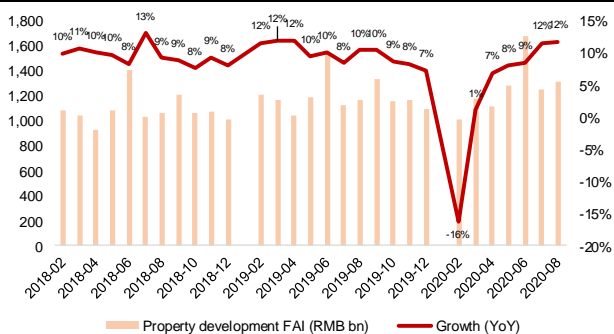
Source: Wind, NBS, CMBIS

**Figure 17: China infrastructure FAI (monthly)**



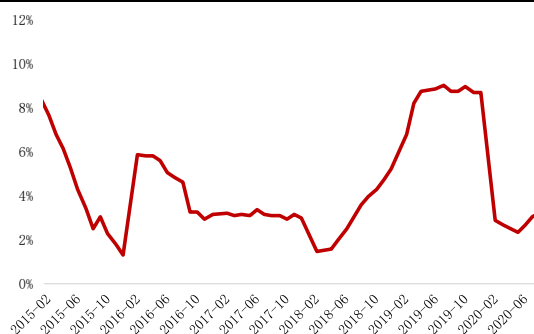
Source: Wind, NBS, CMBIS

**Figure 18: China property development FAI**



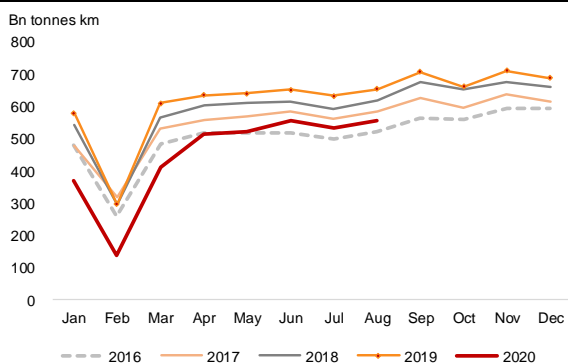
Source: NBS, Wind, CMBIS

**Figure 19: Area under construction (Growth YoY)**



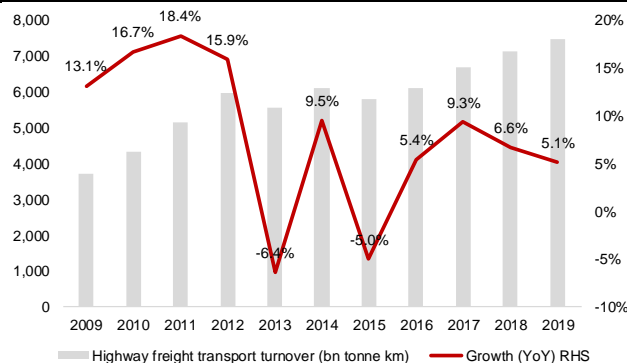
Source: NBS, Wind, CMBIS

**Figure 20: China highway freight transport turnover (monthly)**



Source: NBS, Wind, CMBIS

**Figure 21: China highway freight transport turnover (yearly)**



Source: Wind, NBS, CMBIS

# Weichai Power-H (2338 HK)

## A beneficiary of industry consolidation

Weichai is set to become a major beneficiary upon the implementation of NES VI(a) in mid-2021E, on the back of its leading technology. While we trimmed our 2020E earnings forecast by 5% due mainly to revised margin assumptions, we lifted our 2021E-22E forecast by 3-4% after incorporating our new industry forecast. Our SOTP-based TP is raised to HK\$19.2 from HK\$18.6. We believe concerns on margin weakness is already in the price, while strong upcoming HDT sales data points and improvement in 3Q results will serve as near term catalyst. Maintain **BUY**.

- Expect an acceleration of industry consolidation upon the implementation of NES VI (a).** We believe the HDT engine industry will further consolidate after the implementation of the new strict emission standard. Weichai is set to benefit given its leading technology driven by high commitment in R&D over the past decade. Weichai recently announced the first commercial diesel engine in the world with thermal efficiency of >50%, above the industry average of ~46%.
- Gross margin of gas engine recovered.** Weichai's gross margin in 2Q20 was hurt by the high price of precious metals that used in the production of gas engine. Weichai has already reduced the use of such metals in order to reduce cost. At present, the gross margin of gas engine has already returned to a level similar to that of diesel engine, based on our understanding.
- Change in assumptions.** We revise up Weichai's total engine sales volume projection by 4-6% in 2020E-22E. Given that Weichai is rapidly expanding its non-road engine business, we fine-tuned our engine segment margin by -1 to -2ppt as we expect non-road engines will carry lower margin at the beginning stage. Our current forecast has yet to include the potential contribution from fuel cell batteries.
- Risk factors:** (1) unexpected slowdown of HDT and engine demand; (2) rebound of COVID-19 cases in overseas; (3) technology risk.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	159,256	174,361	183,616	194,001	202,659
YoY growth (%)	5.1	9.5	5.3	5.7	4.5
Net income (RMB mn)	8,658	9,105	9,595	11,494	12,253
EPS (RMB)	1.08	1.15	1.21	1.45	1.54
YoY growth (%)	27.2	6.0	5.4	19.8	6.6
Consensus EPS (RMB)	n/a	n/a	1.23	1.41	1.50
P/E (x)	12.1	11.7	10.9	9.1	8.5
EV / EBITDA (x)	5.6	5.2	5.3	4.5	4.3
P/B (x)	2.6	2.4	2.0	1.7	1.5
Yield (%)	3.5	2.1	3.7	4.4	4.7
ROE (%)	23.2	21.5	19.6	20.4	19.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

## BUY (Maintain)

Target Price	HK\$19.20
(Previous TP)	HK\$18.60)
Up/Downside	+28%
Current Price	HK\$15.04

### China Capital Goods

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#### Stock Data

Mkt Cap (HK\$ mn)	131,033
Avg 3 mths t/o (HK\$ mn)	178
52w High/Low (HK\$)	18.6/10.80
Total Issued Shares (mn)	1,934 (H)
	5,991 (A)

Source: Bloomberg

#### Shareholding Structure

Weichai Holdings Group	16.8%
Weifang Investment Group	3.7%
Free float (H-share)	24.2%
Free float (A-share)	55.3%

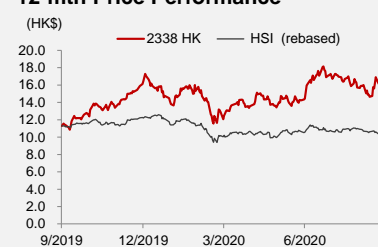
Source: HKEX

#### Share Performance

	Absolute	Relative
1-mth	-8.3%	-0.3%
3-mth	4.9%	10.9%
6-mth	16.0%	17.2%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

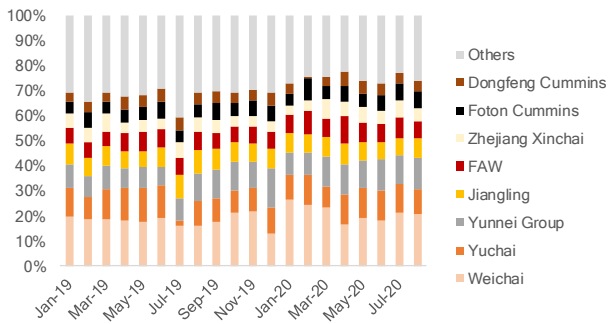
#### Auditor: Ernst & Young

#### Related Reports

- China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020
- Weichai Power (2338 HK, BUY) – Correction offers buying opportunity; Diversification strategy on track – 30 Mar 2020
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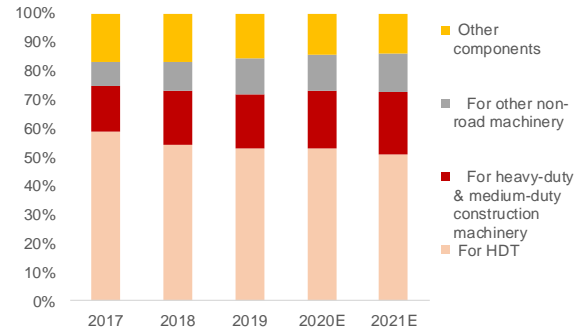


Figure 22: China multi-cylinder engine market share



Source: CICEIA, CMBIS

Figure 23: Weichai's engine sales volume breakdown



Source: Company data, CMBIS estimates

Figure 24: Change in key assumptions

Change in key assumptions	2020E			2021E			2022E		
	Old	New	Change	Old	New	Change	Old	New	Change
<b>Sales volume (unit)</b>									
Engine total	843,768	<b>880,760</b>	4.4%	891,033	<b>935,597</b>	5.0%	935,696	<b>994,954</b>	6.3%
HDT (Shaanxi Heavy-duty Motor)	180,000	<b>183,000</b>	1.7%	177,000	<b>178,000</b>	0.6%	175,000	<b>180,000</b>	2.9%
Gear box (Shaanxi Fast Gear Company)	1,100,000	<b>1,100,000</b>	0.0%	1,100,000	<b>1,100,000</b>	0.0%	1,130,000	<b>1,130,000</b>	0.0%
<b>(RMB mn)</b>									
<b>Revenue</b>									
Diesel engines	56,617	<b>58,747</b>	3.8%	59,788	<b>62,404</b>	4.4%	62,785	<b>66,363</b>	5.7%
Automobiles and major components	78,080	<b>79,033</b>	1.2%	77,897	<b>78,725</b>	1.1%	79,605	<b>80,696</b>	1.4%
Forklift trucks & supply chain solution	53,742	<b>61,803</b>	15.0%	61,803	<b>68,601</b>	11.0%	65,511	<b>72,031</b>	10.0%
Intersegment sales	-14,133	<b>-15,967</b>	13.0%	-14,962	<b>-15,730</b>	5.1%	-15,593	<b>-16,432</b>	5.4%
<b>Total revenue</b>	174,306	<b>183,616</b>	5.3%	184,527	<b>194,001</b>	5.1%	192,309	<b>202,659</b>	5.4%
<b>Segment profit</b>									
Diesel engines	9,512	<b>8,812</b>	-7.4%	10,044	<b>9,860</b>	-1.8%	10,548	<b>10,485</b>	-0.6%
Automobiles and major components	3,123	<b>2,529</b>	-19.0%	3,116	<b>2,834</b>	-9.0%	3,184	<b>2,905</b>	-8.8%
Forklift trucks & supply chain solution	1,720	<b>1,978</b>	15.0%	3,585	<b>3,979</b>	11.0%	3,865	<b>4,178</b>	8.1%
Intersegment sales	-141	<b>-160</b>	13.0%	-150	<b>-157</b>	5.1%	-156	<b>-164</b>	5.4%
<b>Total segment profit</b>	14,213	<b>13,159</b>	-7.4%	16,595	<b>16,516</b>	-0.5%	17,441	<b>17,404</b>	-0.2%
<b>Segment margin</b>									
		<b>Change (ppt)</b>			<b>Change (ppt)</b>			<b>Change (ppt)</b>	
Diesel engines	16.8%	<b>15.0%</b>	-1.8	16.8%	<b>15.8%</b>	-1.0	16.8%	<b>15.8%</b>	-1.0
Automobiles and major components	4.0%	<b>3.2%</b>	-0.8	4.0%	<b>3.6%</b>	-0.4	4.0%	<b>3.6%</b>	-0.4
Forklift trucks & supply chain solution	3.2%	<b>3.2%</b>	0.0	5.8%	<b>5.8%</b>	0.0	5.9%	<b>5.8%</b>	-0.1
<b>Average</b>	8.2%	<b>7.2%</b>	-1.0	9.0%	<b>8.5%</b>	-0.5	9.1%	<b>8.6%</b>	-0.5

Source: Company data, CMBIS estimates

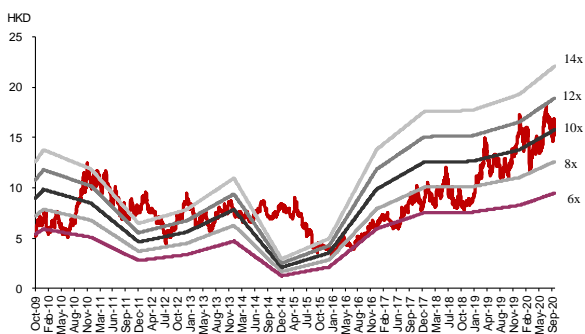
Figure 25: SOTP valuation

SOTP valuation	Valuation methodology	Target multiple (x)	EBITDA 2020E (RMB mn)	Estimated EV (RMB mn)	Net cash / (Net debt)	Equity value (RMB mn)
Weichai core business	EV/EBITDA	6	13,475	80,848	21,189	102,037
KION Group	Proportionate market value	-	-	-	-	30,563
Share of JV/associates	PB	2.5	-	-	-	11,778
Minority interest (Weichai core business)						-10,835
<b>Total NAV</b>						<b>133,542</b>
<b>NAV per share (RMB)</b>						<b>16.8</b>
<b>NAV per share (HK\$)</b>						<b>19.2</b>

Source: Company data, CMBIS estimates

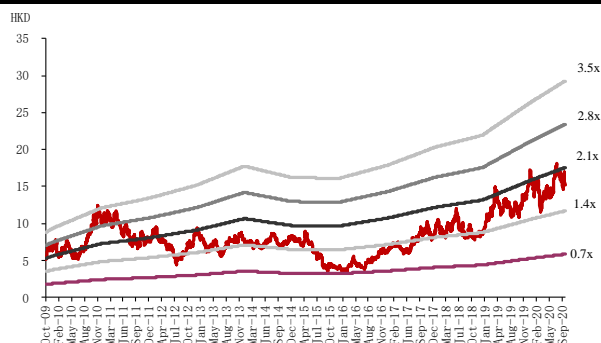


**Figure 26: Weichai Power-H P/E band**



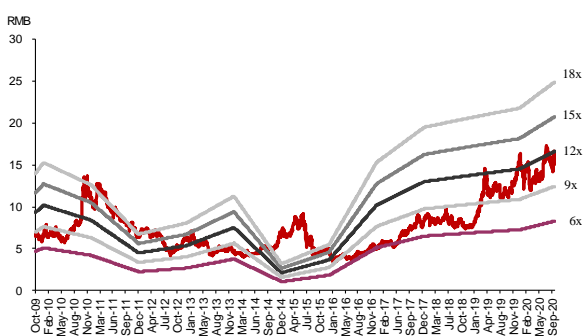
Source: Bloomberg, Company data, CMBIS estimates

**Figure 27: Weichai Power-H P/B band**



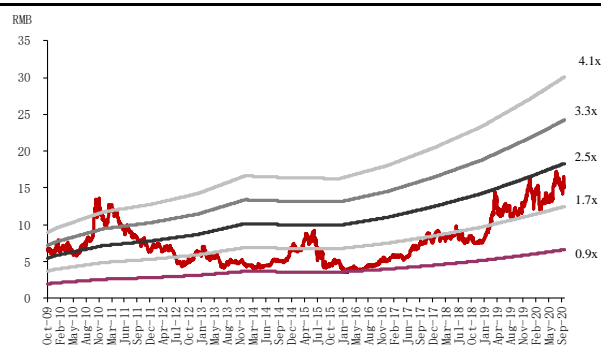
Source: Bloomberg, Company data, CMBIS estimates

**Figure 28: Weichai Power-A P/E band**



Source: Bloomberg, Company data, CMBIS estimates

**Figure 29: Weichai Power-A P/B band**



Source: Bloomberg, Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>159,256</b>	<b>174,361</b>	<b>183,616</b>	<b>194,001</b>	<b>202,659</b>
Cost of sales	-123,686	-136,353	-146,525	-153,648	-160,506
<b>Gross profit</b>	<b>35,569</b>	<b>38,008</b>	<b>37,090</b>	<b>40,352</b>	<b>42,153</b>
Operating expenses	-21,757	-23,586	-23,069	-22,961	-23,872
<b>EBIT</b>	<b>13,812</b>	<b>14,422</b>	<b>14,021</b>	<b>17,391</b>	<b>18,281</b>
Other expenses	-52	-94	-220	-233	-243
Net finance cost	-75	-220	-20	246	527
Finance income and others	1,060	1,067	1,279	1,518	1,782
Finance expenses	-1,135	-1,288	-1,299	-1,272	-1,255
profit of JV & associates	174	244	238	243	248
<b>Pretax profit</b>	<b>13,858</b>	<b>14,352</b>	<b>14,019</b>	<b>17,647</b>	<b>18,813</b>
Income tax	-2,233	-2,445	-2,173	-2,912	-3,104
<b>After tax profit</b>	<b>11,626</b>	<b>11,907</b>	<b>11,846</b>	<b>14,735</b>	<b>15,709</b>
MI	-2,968	-2,802	-2,251	-3,242	-3,456
<b>Net profit</b>	<b>8,658</b>	<b>9,105</b>	<b>9,595</b>	<b>11,494</b>	<b>12,253</b>
D&A	7,404	8,071	8,144	8,798	9,453
<b>EBITDA</b>	<b>21,216</b>	<b>22,493</b>	<b>22,165</b>	<b>26,189</b>	<b>27,734</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Pretax profit	13,858	14,352	14,019	17,647	18,813
Finance cost	1,135	1,288	1,299	1,272	1,255
Interest income	-1,060	-1,067	-1,279	-1,518	-1,782
Share of profit or loss of associates	-174	-244	-238	-243	-248
Depreciation	5,321	6,188	6,218	6,872	7,527
Amortization of intangible assets	2,016	1,820	1,863	1,863	1,863
Income tax paid	-2,233	-2,445	-2,173	-2,912	-3,104
Change in working capital	2,363	2,603	-785	288	-547
Others	1,035	1,341	1,342	1,581	1,845
<b>Cash flow from operation</b>	<b>22,262</b>	<b>23,835</b>	<b>20,265</b>	<b>24,850</b>	<b>25,622</b>
Net capex on PP&E	-1,952	-6,335	-7,000	-8,500	-8,500
Investment in JV/associates	-1,655	-243	0	0	0
Investment in subsidiaries	0	0	0	0	0
Dividend received	181	135	143	146	149
Others	-3,754	-1,947	0	0	0
<b>Cash flow from investing</b>	<b>-7,181</b>	<b>-8,391</b>	<b>-6,857</b>	<b>-8,354</b>	<b>-8,351</b>
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	635	1,137	-900	-400	-400
Dividend paid	-4,039	-4,851	-2,269	-3,838	-4,597
Interest paid	0	0	-1,299	-1,272	-1,255
Others	-3,577	-3,853	0	0	0
<b>Cash flow from financing</b>	<b>-6,980</b>	<b>-7,567</b>	<b>-4,468</b>	<b>-5,510</b>	<b>-6,252</b>
Change in cash	8,100	7,877	8,940	10,986	11,019
Cash at beginning of the year	34,222	38,210	48,818	57,758	68,744
Exchange gains/(losses) and others	-4,112	2,731	0	0	0
Cash at the end of the year	38,210	48,818	57,758	68,744	79,763

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>97,171</b>	<b>110,647</b>	<b>109,661</b>	<b>109,523</b>	<b>108,733</b>
PP&E	29,453	26,316	27,098	28,726	29,700
Investment in JV/associates	4,464	4,711	4,806	4,903	5,002
Goodwill	23,037	23,823	23,823	23,823	23,823
Long term receivables	6,483	8,448	8,448	8,448	8,448
Intangible assets	23,299	23,436	21,573	19,710	17,847
Others	10,434	23,914	23,914	23,914	23,914
<b>Current assets</b>	<b>108,105</b>	<b>126,185</b>	<b>135,412</b>	<b>150,034</b>	<b>160,969</b>
Prepayments	1,109	997	934	871	808
Inventories	20,674	24,718	23,455	27,060	25,710
Trade receivables	13,155	14,285	15,898	15,992	17,321
Notes receivables	24,993	26,458	26,458	26,458	26,458
Others	9,964	10,910	10,910	10,910	10,910
Cash	38,210	48,818	57,758	68,744	79,763
<b>Current liabilities</b>	<b>88,617</b>	<b>105,877</b>	<b>105,542</b>	<b>109,629</b>	<b>109,161</b>
Trade and bills payables	30,869	36,749	36,313	40,300	39,733
Notes payable	15,925	22,446	22,446	22,446	22,446
Bank borrowings	12,371	15,013	15,113	15,213	15,313
Others	29,451	31,669	31,669	31,669	31,669
<b>Non-current liabilities</b>	<b>54,400</b>	<b>61,180</b>	<b>60,180</b>	<b>59,680</b>	<b>59,180</b>
Bank borrowings	23,174	21,669	20,669	20,169	19,669
Long term payables	19,475	16,325	16,325	16,325	16,325
Others	11,751	23,186	23,186	23,186	23,186
<b>Equity</b>	<b>62,259</b>	<b>69,775</b>	<b>79,352</b>	<b>90,249</b>	<b>101,361</b>
Shareholders' equity	39,314	45,224	52,550	60,206	67,861
MI	22,946	24,551	26,802	30,043	33,499

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Diesel engines	28.2	28.7	32.0	32.2	32.7
Automobiles and major components	42.0	41.0	43.0	40.6	39.8
Forklift trucks & supply chain solution	38.0	38.5	33.7	35.4	35.5
Intersegment sales	(8.2)	(8.2)	(8.7)	(8.1)	(8.1)
Total	100.0	100.0	100.0	100.0	100.0
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	22.3	21.8	20.2	20.8	20.8
EBIT margin	8.7	8.3	7.6	9.0	9.0
After tax profit margin	7.3	6.8	6.5	7.6	7.8
<b>Growth (%)</b>					
Revenue	5.1	9.5	5.3	5.7	4.5
Gross profit	7.5	6.9	(2.4)	8.8	4.5
EBIT	23.4	4.4	(2.8)	24.0	5.1
Net profit	27.2	5.2	5.4	19.8	6.6
<b>Balance sheet ratio</b>					
Current ratio (x)	1.2	1.2	1.3	1.4	1.5
Receivable turnover days	31	29	30	30	30
Inventory turnover days	60	61	60	60	60
Payable turnover days	91	91	91	91	91
Net debt / total equity (%)					
Net cash	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Profitability (%)</b>					
ROA	5.9	5.4	4.9	5.8	5.9
ROE	23.2	21.5	19.6	20.4	19.1
<b>Per share data</b>					
EPS (RMB)	1.08	1.15	1.21	1.45	1.54
BVPS (RMB)	4.96	5.70	6.62	7.59	8.55
DPS (RMB)	0.46	0.29	0.48	0.58	0.62

Source: Company data, CMBIS estimates

# Weichai Power-A (000338 CH)

## A beneficiary of industry consolidation

Weichai is set to become a major beneficiary upon the implementation of NES VI(a) in mid-2021E, on the back of its leading technology. While we trimmed our 2020E earnings forecast by 5% due mainly to revised margin assumptions, we lifted our 2021E-22E forecast by 3-4% after incorporating our new industry forecast. Our SOTP-based TP is raised to RMB16.8 from RMB16.6. We believe concerns on margin weakness is already in the price, while strong upcoming HDT sales data points and improvement in 3Q results will serve as near term catalyst. Maintain **BUY**.

- Expect an acceleration of industry consolidation upon the implementation of NES VI (a).** We believe the HDT engine industry will further consolidate after the implementation of the new strict emission standard. Weichai is set to benefit given its leading technology driven by high commitment in R&D over the past decade. Weichai recently announced the first commercial diesel engine in the world with thermal efficiency of >50%, above the industry average of ~46%.
- Gross margin of gas engine recovered.** Weichai's gross margin in 2Q20 was hurt by the high price of precious metals that used in the production of gas engine. Weichai has already reduced the use of such metals in order to reduce cost. At present, the gross margin of gas engine has already returned to a level similar to that of diesel engine, based on our understanding.
- Change in assumptions.** We revise up Weichai's total engine sales volume projection by 4-6% in 2020E-22E. Given that Weichai is rapidly expanding its non-road engine business, we fine-tuned our engine segment margin by -1 to -2ppt as we expect non-road engines will carry lower margin at the beginning stage. Our current forecast has yet to include the potential contribution from fuel cell batteries.
- Risk factors:** (1) unexpected slowdown of HDT and engine demand; (2) rebound of COVID-19 cases in overseas; (3) technology risk.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	159,256	174,361	183,616	194,001	202,659
YoY growth (%)	5.1	9.5	5.3	5.7	4.5
Net income (RMB mn)	8,658	9,105	9,595	11,494	12,253
EPS (RMB)	1.08	1.15	1.21	1.45	1.54
YoY growth (%)	27.2	6.0	5.4	19.8	6.6
Consensus EPS (RMB)	n/a	n/a	1.23	1.41	1.50
P/E (x)	13.7	13.3	12.4	10.3	9.7
EV / EBITDA (x)	6.2	5.9	6.0	5.0	4.8
P/B (x)	3.0	2.7	2.3	2.0	1.7
Yield (%)	3.1	1.9	3.2	3.9	4.1
ROE (%)	23.2	21.5	19.6	20.4	19.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

## BUY (Maintain)

Target Price	RMB16.80
(Previous TP)	RMB16.60)
Up/Downside	+12%
Current Price	RMB14.95

### China Capital Goods

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#### Stock Data

Mkt Cap (RMB mn)	115,269
Avg 3 mths t/o (RMB mn)	902
52w High/Low (RMB)	17.40/11.03
Total Issued Shares (mn)	1,934 (H)
	5,991 (A)

Source: Bloomberg

#### Shareholding Structure

Weichai Holdings Group	16.8%
Weifang Investment Group	3.7%
Free float (H-share)	24.2%
Free float (A-share)	55.3%

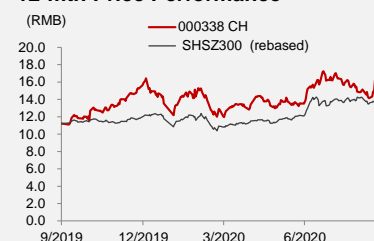
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-3.2%	0.2%
3-mth	10.6%	0.1%
6-mth	18.6%	-3.7%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Ernst & Young

#### Related Reports

- China Construction Machinery & HDT Sector – Raise industry sales forecast in 2020E-21E; Solid upcycle – 30 Jun 2020
- Weichai Power (2338 HK, BUY) – Correction offers buying opportunity; Diversification strategy on track – 30 Mar 2020
- China Construction Machinery Sector – Four structural drivers to extend the upcycle to 2020-21E – 27 Nov 2019

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<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
<b>UNDERPERFORM</b>	: Industry expected to underperform the relevant broad market benchmark over next 12 months

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