

# Jiangsu Hengli Hydraulic (601100 CH)

## 3Q19 profit slightly below estimate but recovery seen in Oct

Hengli's net profit in 3Q19 dropped ~4% YoY to RMB246mn, dragged by a decline in the sales volume of hydraulic cylinders which also resulted in a lower gross margin. While the result is slightly below expectations, we believe the weakness was temporary as the capacity utilization rate recovered to 100% in Oct based on our understanding. We believe any share price weakness today offers entry opportunity. We continue to like Hengli for its import substitution growth story on hydraulic cylinder, pump and valve, which we believe is structural in nature. Stock is trading at 28x 2019E P/E.

■ **Key highlights on 3Q19 results.** Revenue slightly grew 4.5% YoY to RMB1.04bn in 3Q19, which was due to a 30% YoY sales volume decline of hydraulic cylinder for medium-size excavators. This also led to a contraction of 3.3ppt YoY on blended gross margin to 35.3%. Besides, R&D expense increased 36% YoY to RMB60.8mn. That said, the R&D spending growth is understandable as several tranches of new products are under development. All these resulted in a 3.8% YoY decline in net profit to RMB246mn.

■ **9M19 net profit accounted for 75% of consensus earnings.** Revenue and net profit grew 21% YoY and 27% YoY, respectively, to RMB3.8bn and RMB917mn, driven by (1) 15% YoY revenue growth of hydraulic cylinder for excavator, (2) 8% YoY increase in non-standardized hydraulic cylinder for heavy equipment; (3) 86% YoY increase in hydraulic pump and valve. Operating cash flow surged 216% YoY to RMB1.17bn, higher than the net profit. Based on our check, the Company is running at full utilization rate with two shifts per day in Oct, due to order recovery. We expect earnings growth to resume in 4Q19E.

■ **Key risks:** (1) weakness in demand for excavators; (2) increase in component cost.

### Earnings Summary

| (YE 31 Dec)         | FY16A | FY17A | FY18A    |
|---------------------|-------|-------|----------|
| Revenue (RMB mn)    | 1,370 | 2,795 | 4,211    |
| YoY growth (%)      | 26.0  | 104.0 | 50.6     |
| Net income (RMB mn) | 70    | 382   | 837      |
| EPS (RMB)           | 0.08  | 0.43  | 0.95     |
| YoY growth (%)      | 10.8  | 442.9 | 119.1    |
| EV/EBITDA (x)       | 214.1 | 52.6  | 31.3     |
| P/E (x)             | 490.9 | 90.4  | 41.3     |
| P/B (x)             | 9.9   | 9.0   | 7.6      |
| Yield (%)           | 0.1   | 0.4   | 0.8      |
| ROE (%)             | 2.0   | 10.4  | 19.9     |
| Net gearing (%)     | 3.3   | 5.0   | Net cash |

Source: Company data, CMBIS estimates

**NOT RATED**
**Current Price**
**RMB39.16**

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#### Stock Data

|                          |             |
|--------------------------|-------------|
| Mkt Cap (RMB mn)         | 34,539      |
| Avg 3 mths t/o (RMB mn)  | 155         |
| 52w High/Low (RMB)       | 42.00/17.55 |
| Total Issued Shares (mn) | 882         |

Source: Bloomberg

#### Shareholding Structure

|                   |       |
|-------------------|-------|
| WANG's family     | 71.0% |
| CCASS (Hong Kong) | 6.5%  |
| Deutsche Bank AG  | 2.2%  |
| Free float        | 20.3% |

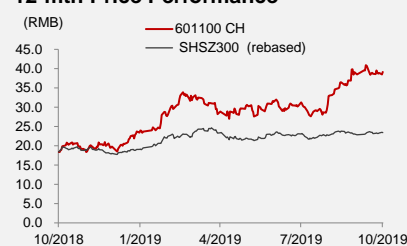
Source: Company data

#### Share Performance

|       | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -1.5%    | -3.4%    |
| 3-mth | +26.9%   | +24.7%   |
| 6-mth | +36.6%   | +35.3%   |

Source: Bloomberg

#### 12-mth Price Performance



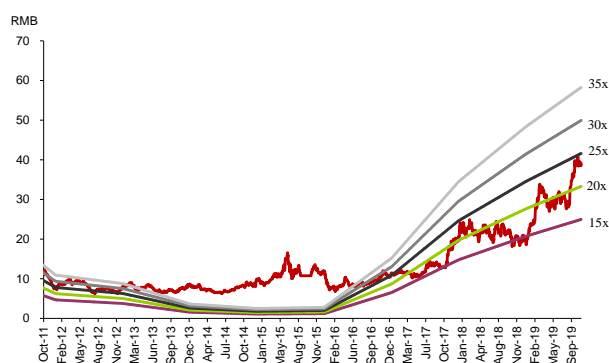
Source: Bloomberg

**Auditor: RSM**

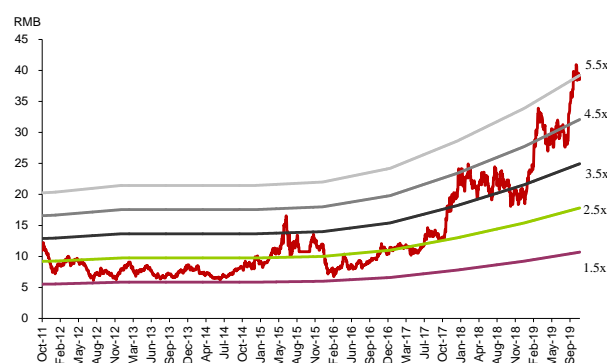
**Figure 1: Key highlights of 3Q19 results**

| (RMB mn)                             | 1Q18       | 1Q19         | Change YoY    | 2Q18         | 2Q19         | Change YoY   | 3Q18       | 3Q19         | Change YoY   |
|--------------------------------------|------------|--------------|---------------|--------------|--------------|--------------|------------|--------------|--------------|
| <b>Total revenue</b>                 | <b>970</b> | <b>1,569</b> | <b>61.6%</b>  | <b>1,194</b> | <b>1,224</b> | <b>2.6%</b>  | <b>996</b> | <b>1,041</b> | <b>4.5%</b>  |
| Cost of sales                        | (641)      | (1,023)      | 59.7%         | (775)        | (736)        | -5.0%        | (611)      | (674)        | 10.3%        |
| <b>Gross profit</b>                  | <b>330</b> | <b>546</b>   | <b>65.5%</b>  | <b>419</b>   | <b>488</b>   | <b>16.6%</b> | <b>385</b> | <b>367</b>   | <b>-4.6%</b> |
| Other income                         | (10)       | (15)         | 46.7%         | (13)         | (11)         | -20.2%       | (10)       | (12)         | 27.5%        |
| S&D expenses                         | (23)       | (19)         | -17.0%        | (25)         | (29)         | 15.5%        | (38)       | (31)         | -18.7%       |
| Administrative expenses              | (74)       | (95)         | 28.3%         | (86)         | (113)        | 32.1%        | (98)       | (104)        | 6.8%         |
| Asset impairment                     | (8)        | (21)         | 171.1%        | (3)          | 8            | n/a          | (2)        | (1)          | -45.2%       |
| <b>EBIT</b>                          | <b>214</b> | <b>395</b>   | <b>84.3%</b>  | <b>292</b>   | <b>344</b>   | <b>17.8%</b> | <b>237</b> | <b>218</b>   | <b>-8.1%</b> |
| Net finance income/(cost)            | (49)       | (35)         | -27.7%        | 45           | 50           | 11.3%        | 47         | 43           | -8.5%        |
| Other gains/(loss)                   | 15         | 13           | -13.6%        | 21           | 12           | -45.2%       | 22         | 32           | 47.0%        |
| Share of profit of JV and associates | 0          | 0            | n/a           | 0            | 0            | n/a          | 0          | 0            | n/a          |
| <b>Pretax profit</b>                 | <b>181</b> | <b>373</b>   | <b>106.3%</b> | <b>358</b>   | <b>405</b>   | <b>13.3%</b> | <b>307</b> | <b>294</b>   | <b>-4.2%</b> |
| Income tax                           | (24)       | (47)         | 94.2%         | (50)         | (60)         | 19.5%        | (50)       | (47)         | -6.6%        |
| <b>After tax profit</b>              | <b>157</b> | <b>327</b>   | <b>108.2%</b> | <b>308</b>   | <b>345</b>   | <b>12.2%</b> | <b>256</b> | <b>247</b>   | <b>-3.7%</b> |
| MI                                   | (0)        | (0)          | 384.4%        | (1)          | (1)          | -33.2%       | (0)        | (0)          | 21.8%        |
| <b>Net profit</b>                    | <b>157</b> | <b>326</b>   | <b>108.0%</b> | <b>307</b>   | <b>345</b>   | <b>12.4%</b> | <b>256</b> | <b>246</b>   | <b>-3.8%</b> |

Source: Company data, CMBIS

**Figure 2: 12M forward P/E band**

Source: Bloomberg, Company data, CMBIS

**Figure 3: 12M forward P/B band**

Source: Bloomberg, Company data, CMBIS

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|------------------|---|
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|                       |   |
|-----------------------|---|
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