

# Lonking (3339 HK)

## No improvement in core earnings; Weakening competitive power

Excluding the investment gains and FX change, Lonking's core net profit in 1H20 dropped ~4% YoY to RMB696mn based on our calculation, due to decline in both revenue and gross margin. The structural weakness of wheel loader demand and market share loss on excavator reconfirmed our bearish stance on Lonking's long-term competitive power. We took our 2020E-21E core earnings forecasts down by 4-10%, after revising down both revenue and margin assumptions. We trimmed our TP to HK\$2.22, based on 7x 2020E core earnings (multiple unchanged). Downgrade to **SELL** from Hold. We prefer **Zoomlion (1157 HK / 000157 CH, BUY)** and **SANY Heavy (600031 CH, BUY)**.

- **Reported net profit in 2019 was helped by fair value gains.** Lonking's reported net profit increased by 6% YoY to RMB944mn in 1H20. That said, Lonking reported ~RMB242mn net fair value gains on investment, which accounted for 22% of the total segment results (up from 16% in 1H19). We calculate that the core net profit would be down 4% YoY if excluding such gains. This is a weak set of results given the robust demand for construction machinery for the industry as a whole. Meanwhile, the operating cash inflow in 1H20 dropped 52% YoY to RMB407mn, much lower than the reported net profit.
- **Lack of revenue growth remains a key concern.** Revenue in 1H20 dropped 4% YoY to RMB3.2bn. Revenue from wheel loader sales dropped 4% YoY which is largely within our expectation given the general weakness of wheel loader demand. What's more negative was the 9% YoY decline in excavator revenue in 1H20, in contrast to the 24% YoY increase in excavator sales volume by the major players in China. We believe Lonking's excavator business is faced with rising challenges. SANY Heavy, the largest player in the space of excavator, has consistently gaining market share. Meanwhile, Zoomlion, a relatively new player in the excavator market, is rapidly gaining market share.
- **Upside risks:** (1) recovery of wheel loader and excavator sales; (2) a potential target of acquisition/privatization; (3) Large investment gains.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	11,868	11,744	11,409	11,255	11,263
YoY growth (%)	32.0	-1.0	-2.8	-1.3	0.1
Net income* (RMB mn)	1,144	1,643	1,468	1,142	1,162
EPS (RMB)	0.267	0.384	0.343	0.267	0.272
YoY growth (%)	9.4	43.7	-10.7	-22.3	1.8
Consensus (RMB)	n/a	n/a	0.31	0.31	0.33
EV / EBITDA (x)	4.8	3.5	3.8	4.9	4.9
P/E (x)	8.6	6.1	6.9	8.8	8.7
P/B (x)	1.2	1.1	1.1	1.0	1.0
Yield (%)	7.4	9.7	8.8	6.8	6.9
ROE (%)	14.4	19.0	15.8	11.8	11.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

\*Reported net profit

Source: Company data, Bloomberg, CMBIS estimates

## SELL (Down)

Target Price	HK\$2.22
(Previous TP	HK\$2.30)
Up/Downside	-15%
Current Price	HK\$2.61

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### Stock Data

Mkt Cap (HK\$ mn)	11,171
Avg 3 mths t/o (HK\$ mn)	25
52w High/Low (HK\$)	3.00/1.78
Total Issued Shares (mn)	4,280

Source: Bloomberg

### Shareholding Structure

Li San Yim	56.0%
GIC	7.0%
Others	37.0%

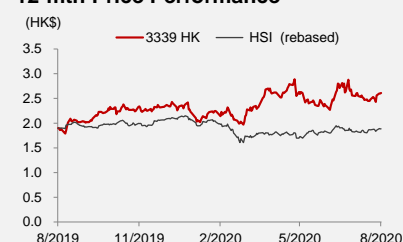
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	1.6%	-1.5%
3-mth	-1.1%	-11.0%
6-mth	20.4%	27.0%

Source: Bloomberg

### 12-mth Price Performance



Source: Wind

### Auditor: Ernst & Young

### Related Reports

1. China Construction Machinery Sector – Sustainable demand for excavator in 2H20E – 12 Aug 2020
2. Lonking (3339 HK, HOLD) – Weak core profit but downside protected by 12% yield – 27 Mar 2020

**Figure 1: Highlight on 1H20 results**

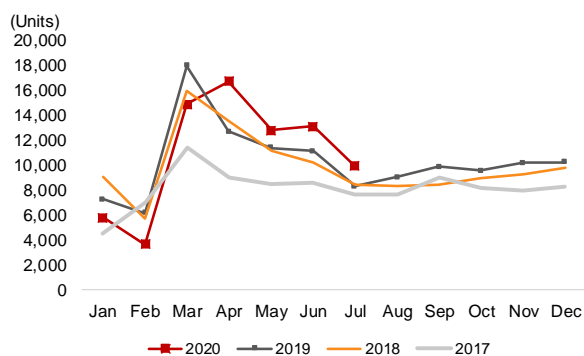
<b>YE Dec 31 (RMB mn)</b>	<b>1H19</b>	<b>1H20</b>	<b>Change (YoY)</b>
<b>Revenue</b>			
Wheel loaders	3,337	3,216	-3.6%
Excavators	1,408	1,283	-8.9%
Road rollers	72	49	-33.0%
Forklifts	1,351	1,349	-0.2%
Others	590	617	4.6%
Subtotal for construction machinery	6,758	6,513	-3.6%
Finance lease interest income	1	1	-37.2%
<b>Total revenue</b>	<b>6,760</b>	<b>6,514</b>	<b>-3.6%</b>
Cost of sales	(5,188)	(5,023)	-3.2%
<b>Gross profit</b>	<b>1,571</b>	<b>1,491</b>	<b>-5.1%</b>
Other income	29	39	34.8%
Other gains and losses	145	247	70.9%
S&D expenses	(337)	(323)	-4.2%
Administrative expenses	(122)	(120)	-1.6%
R&D costs	(288)	(270)	-6.4%
Other expenses	(10)	(0)	n/a
<b>EBIT</b>	<b>988</b>	<b>1,065</b>	<b>7.8%</b>
Net finance income/(expense)	60	60	0.0%
Finance income	85	74	-13.6%
Finance expenses	(25)	(13)	-46.3%
Share of profit of JV and associates	0	0	n/a
<b>Pretax profit</b>	<b>1,048</b>	<b>1,125</b>	<b>7.3%</b>
Income tax	(159)	(181)	13.7%
After tax profit	889	944	6.2%
MI	(0)	(0)	n/a
<b>Net profit</b>	<b>889</b>	<b>944</b>	<b>6.2%</b>
<b>Core net profit</b>	<b>727</b>	<b>696</b>	<b>-4.2%</b>
D&A	177	153	-13.5%
<b>EBITDA</b>	<b>1,165</b>	<b>1,218</b>	<b>4.5%</b>
<b>Non-operating or one-off gains/(loss)</b>	<b>162</b>	<b>247</b>	<b>53.2%</b>
Investment gains	164	242	47.8%
FX change	(2)	5	n/a
<b>Key ratios</b>			<b>Change (ppt)</b>
Gross margin	23.2%	22.9%	-0.4
S&D expense ratio	5.0%	5.0%	0.0
Admin expense ratio	1.8%	1.8%	0.0
R&D expense ratio	4.3%	4.1%	-0.1
Net margin	13.1%	14.5%	1.3

Source: Company data, CMBIS

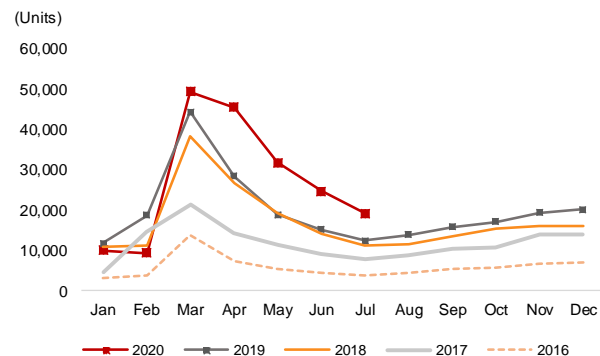
**Figure 2: Key changes in assumptions**

Change in key assumptions	Old			New			Change		
	2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
<b>Revenue (RMB mn)</b>									
Wheel loaders	6,080	5,991	5,931	5,827	5,632	5,576	-4.2%	-6.0%	-6.0%
Excavators	2,091	2,112	2,112	1,954	1,915	1,896	-6.6%	-9.3%	-10.2%
Road rollers	139	142	139	84	82	80	-39.8%	-42.2%	-42.2%
Forklifts	2,560	2,636	2,689	2,380	2,404	2,428	-7.0%	-8.8%	-9.7%
Others	1,162	1,220	1,281	1,162	1,220	1,281	0.0%	0.0%	0.0%
Subtotal for construction machinery	12,031	12,101	12,152	11,407	11,253	11,261	-5.2%	-7.0%	-7.3%
Finance lease interest income	2	2	2	2	2	2	0.0%	0.0%	0.0%
<b>Total revenue</b>	<b>12,034</b>	<b>12,104</b>	<b>12,155</b>	<b>11,409</b>	<b>11,255</b>	<b>11,263</b>	<b>-5.2%</b>	<b>-7.0%</b>	<b>-7.3%</b>
							ppt	ppt	ppt
<b>Gross margin</b>	<b>23.3%</b>	<b>22.9%</b>	<b>22.8%</b>	<b>22.8%</b>	<b>22.4%</b>	<b>22.3%</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.5</b>
Reported net profit	1,271	1,249	1,302	1,468	1,142	1,162	15.6%	-8.6%	-10.8%
<b>Core net profit</b>	<b>1,271</b>	<b>1,249</b>	<b>1,302</b>	<b>1,221</b>	<b>1,142</b>	<b>1,162</b>	<b>-3.9%</b>	<b>-8.6%</b>	<b>-10.8%</b>

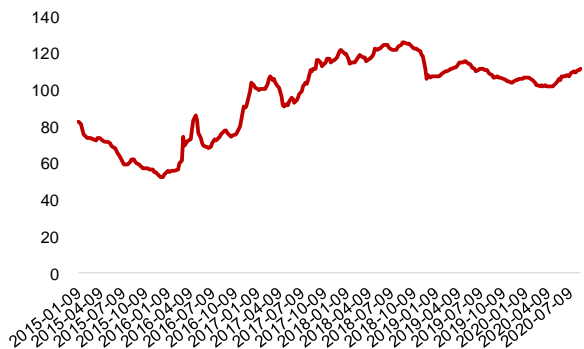
Source: Company data, CMBIS

**Figure 3: China's wheel loader monthly sales**

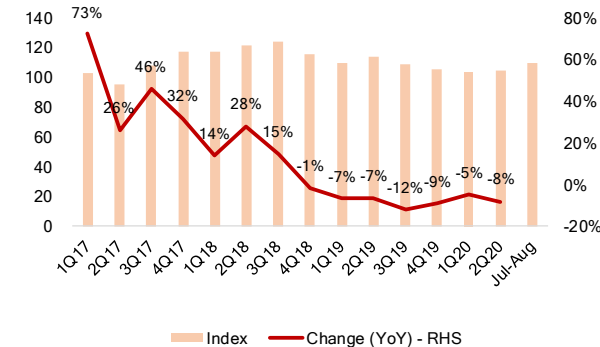
Source: CCMA, CMBIS

**Figure 4: China's excavator monthly sales**

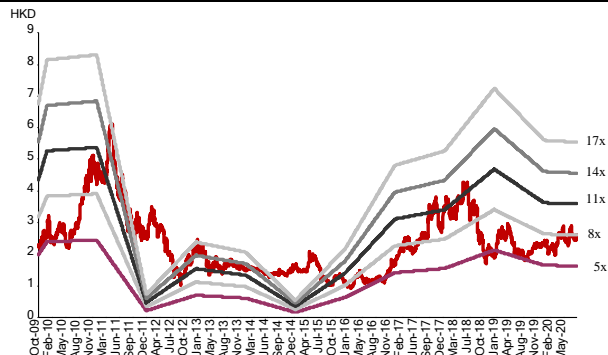
Source: CCMA, CMBIS

**Figure 5: China medium-thick steel plate price index**

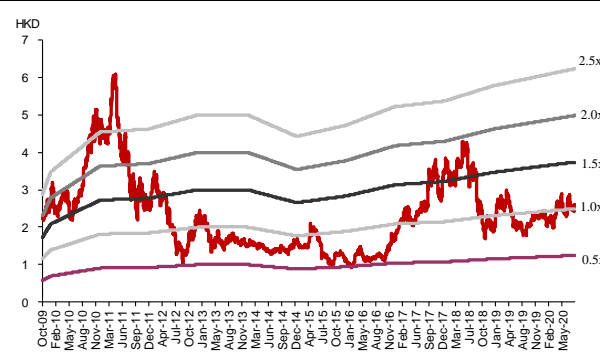
Source: Wind, CMBIS

**Figure 6: China medium thick plate quarterly pricing**

Source: Wind, CMBIS

**Figure 7: Lonking's P/E band**

Source: Bloomberg, Company data, CMBIS estimates

**Figure 8: Lonking's P/B band**

Source: Bloomberg, Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>11,868</b>	<b>11,744</b>	<b>11,409</b>	<b>11,255</b>	<b>11,263</b>
Cost of sales	(9,144)	(8,933)	(8,810)	(8,734)	(8,748)
<b>Gross profit</b>	<b>2,725</b>	<b>2,811</b>	<b>2,599</b>	<b>2,521</b>	<b>2,516</b>
Other income	83	102	57	56	56
Other gains and losses	(159)	350	354	0	0
S&D expenses	(640)	(624)	(605)	(597)	(597)
Administrative expenses	(233)	(238)	(234)	(231)	(231)
R&D costs	(545)	(550)	(525)	(518)	(518)
Other expenses	(1)	(11)	(11)	(11)	(11)
<b>EBIT</b>	<b>1,230</b>	<b>1,840</b>	<b>1,635</b>	<b>1,221</b>	<b>1,215</b>
Net finance income	89	125	131	147	178
Finance income	136	165	156	172	203
Finance expenses	(47)	(40)	(25)	(25)	(25)
Profit of JV & associates	0	0	0	0	0
<b>Pretax profit</b>	<b>1,319</b>	<b>1,965</b>	<b>1,766</b>	<b>1,369</b>	<b>1,393</b>
Income tax	(175)	(321)	(297)	(226)	(230)
After tax profit	1,144	1,644	1,469	1,143	1,163
MI	(0)	(1)	(1)	(1)	(1)
<b>Net profit</b>	<b>1,144</b>	<b>1,643</b>	<b>1,468</b>	<b>1,142</b>	<b>1,162</b>
<b>Core net profit</b>	<b>1,337</b>	<b>1,272</b>	<b>1,221</b>	<b>1,142</b>	<b>1,162</b>
D&A	353	349	346	345	344
<b>EBITDA</b>	<b>1,583</b>	<b>2,190</b>	<b>1,980</b>	<b>1,566</b>	<b>1,559</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Pretax profit</b>	<b>1,319</b>	<b>1,965</b>	<b>1,766</b>	<b>1,369</b>	<b>1,393</b>
Finance cost	47	40	25	25	25
Interest income	(136)	(165)	(156)	(172)	(203)
Impairment of trade & other receivables	(43)	14	0	0	0
Write off of inventories	(0)	8	0	0	0
Depreciation and amortization	353	349	346	345	344
Interest received	89	134	156	172	203
Income tax paid	(410)	(300)	(297)	(226)	(230)
Change in working capital	(604)	294	(502)	147	8
Others	197	(768)	0	0	0
<b>Cash flow from operation</b>	<b>811</b>	<b>1,571</b>	<b>1,337</b>	<b>1,660</b>	<b>1,540</b>
Net capex on PP&E	(320)	(179)	(200)	(200)	(100)
Investment in JV/associates	0	0	0	0	0
Interest received	22	0	0	0	0
Others	740	(491)	0	0	0
<b>Cash flow from investing</b>	<b>442</b>	<b>(670)</b>	<b>(200)</b>	<b>(200)</b>	<b>(100)</b>
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	(285)	(594)	0	0	0
Dividend paid	(549)	(732)	(976)	(881)	(685)
Interest paid	(46)	(43)	(25)	(25)	(25)
Others	558	404	0	0	0
<b>Cash flow from financing</b>	<b>(322)</b>	<b>(965)</b>	<b>(1,000)</b>	<b>(906)</b>	<b>(710)</b>
Change in cash	931	(63)	137	554	730
Cash at beginning of the year	1,634	2,565	2,502	2,639	3,192
Exchange and others	1	(0)	0	0	0
Cash at the end of the year	2,565	2,502	2,639	3,192	3,923

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>3,832</b>	<b>3,788</b>	<b>3,642</b>	<b>3,497</b>	<b>3,253</b>
PP&E	2,189	2,081	1,935	1,791	1,547
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
<b>Current assets</b>	<b>10,240</b>	<b>10,830</b>	<b>11,169</b>	<b>11,719</b>	<b>12,356</b>
Inventories	2,858	3,006	2,884	3,146	2,845
Finance lease receivables	21	10	10	10	10
Trade and bills receivables	2,529	2,245	2,569	2,303	2,510
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	2,639	3,192	3,923
<b>Current liabilities</b>	<b>4,479</b>	<b>4,741</b>	<b>4,441</b>	<b>4,585</b>	<b>4,499</b>
Trade and bills payables	3,507	3,650	3,350	3,494	3,408
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
<b>Non-current liabilities</b>	<b>1,387</b>	<b>799</b>	<b>799</b>	<b>799</b>	<b>799</b>
Bank borrowings	1,287	709	709	709	709
Deferred tax liabilities	63	66	66	66	66
Others	37	24	24	24	24
<b>Equity</b>	<b>8,207</b>	<b>9,077</b>	<b>9,570</b>	<b>9,832</b>	<b>10,311</b>
Shareholders' equity	8,205	9,074	9,567	9,828	10,305
MI	3	3	3	4	6

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Wheel loaders	52	51	51	50	50
Excavators	18	18	17	17	17
Road rollers	1	1	1	1	1
Forklifts	19	20	21	21	22
Others	10	9	10	11	11
Finance lease interest income	0	0	0	0	0
Total	100	100	100	100	100
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	23.0	23.9	22.8	22.4	22.3
EBITDA margin	13.3	18.6	17.4	13.9	13.8
EBIT margin	10.4	15.7	14.3	10.8	10.8
Net profit margin	9.6	14.0	12.9	10.2	10.3
<b>Growth (%)</b>					
Revenue	32	-1	-3	-1	0
Gross profit	14	3	-8	-3	0
EBITDA	-8	38	-10	-21	0
EBIT	-10	50	-11	-25	-1
Net profit	9	44	-11	-22	2
Core net profit	47	-5	-4	-6	2
<b>Balance sheet ratio</b>					
Current ratio (x)	3.1	3.1	3.3	3.3	3.5
Receivable turnover days	69	74	77	79	78
Inventory turnover days	106	120	122	126	125
Payable turnover days	136	146	145	143	144
<b>Net debt / total equity (%)</b>	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Profitability (%)</b>					
ROA	8.2	11.5	10.0	7.6	7.5
ROE	14.4	19.0	15.8	11.8	11.5
<b>Per share data</b>					
EPS (RMB)	0.27	0.38	0.34	0.27	0.27
BVPS (RMB)	1.92	2.12	2.24	2.30	2.41
DPS (RMB)	0.17	0.23	0.21	0.16	0.16

Source: Company data, CMBIS estimates

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