

Weichai Power-H (2338 HK)

Growth set to resume after the weak 2020 results

We believe the weak 2020 results has been largely priced in following the recent share price correction. We expect Weichai's earnings growth to resume in 2021E-22E, driven by the synergies with **Sinotruk (3808 HK, BUY)**, recovery of KION's earnings and on-track development of new business including large-bore engine hydraulic powertrain for construction machinery and CVT powertrain for agricultural machinery. We raise our earnings forecast in 2021E/22E by 2%/5%. Our SOTP-based TP is lifted from HK\$20.8 to HK\$27.6. **Key catalysts:** (1) breakthrough in the sales volume of hydrogen fuel cell vehicles; (2) better-than-expected HDT sales; (3) potential M&A for new energy business. Maintain **BUY**.

- **Expectation on HDT demand is bearish enough.** We believe both industry players and market have already expected a slowdown of China HDT demand in 2H21E due to the upcoming implementation of NES VI, which implies a sales decline of ~13-20% YoY (to 1.3-1.4mn units) for the full year. With HDT sales volume already reaching 532k units in 1Q21 (+94% YoY), market is expecting a decline of 37-43% YoY in Apr-Dec 2021. Such bearish expectation will easily trigger a share price recovery once the monthly sales over the coming months remain strong, in our view. On the other hand, the implementation of NES VI will potential result in a shift of demand from diesel truck to natural gas truck. Weichai will become a beneficiary given the high market share of >60%.
- **Strong synergies with Sinotruk to continue.** On the back of Weichai's engine supply, Sinotruk's market share in HDT increased from 14% in 2019 to 17% in 2020. Besides, Sinotruk will put more focus on LDT and pickup trucks going forward. We expect Weichai's engines sales will continue to be driven by the proactive strategy taken by Sinotruk.
- **Positive guidance from KION.** KION's adjusted EBIT dropped 36% YoY to EUR547mn in 2020, due to the impact of COVID-19. KION guided revenue growth to be 10-17% while adjusted EBIT is expected to grow 32-46% to EUR720-800mn. This will serve as a key recovery driver for Weichai.
- **Risk factors:** (1) Weaker-than-expected demand of HDT and engine in 2H21E; (2) increase in component cost; (3) risk of new business.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue (RMB mn)	159,256	174,361	197,491	218,291	230,850
YoY growth (%)	5.1	9.5	13.3	10.5	5.8
Net income (RMB mn)	8,658	9,105	9,207	11,955	12,973
EPS (RMB)	1.08	1.15	1.16	1.51	1.64
YoY growth (%)	27.2	6.0	1.1	29.8	8.5
Consensus EPS (RMB)	n/a	n/a	n/a	1.41	1.53
P/E (x)	15.3	14.9	14.4	10.7	9.9
EV / EBITDA (x)	6.7	6.3	6.5	5.5	5.1
P/B (x)	3.4	3.0	2.6	2.1	1.8
Yield (%)	2.8	1.7	0.9	3.7	4.0
ROE (%)	23.2	21.5	19.1	21.1	19.6
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$27.60
(Previous TP	HK\$20.80)
Up/Downside	+45%
Current Price	HK\$19.10

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Stock Data

Mkt Cap (HK\$ mn)	179,686
Avg 3 mths t/o (HK\$ mn)	349
52w High/Low (HK\$)	26.40/12.70
Total Issued Shares (mn)	1,934 (H)
	5,991 (A)

Source: Bloomberg

Shareholding Structure

Weichai Holdings Group	17.7%
Weifang Investment Group	3.7%
CCASS	9.6%
Free float (H-share)	24.4%
Free float (A-share)	44.6%

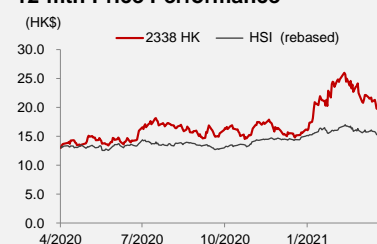
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-13.4%	-12.9%
3-mth	18.0%	12.8%
6-mth	18.6%	-2.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

- China Construction Machinery / HDT Sector – Earnings highlights for Zoomlion, SANY Heavy & Weichai – 31 Mar 2021
- Weichai Power (2338 HK, BUY) – 3Q20 profit +37% with improved margin & KION operation; Upbeat guidance – 2 Nov 2020
- China Heavy-duty Truck Sector – Higher certainty driven by strong policy momentum - 29 Sep 2020

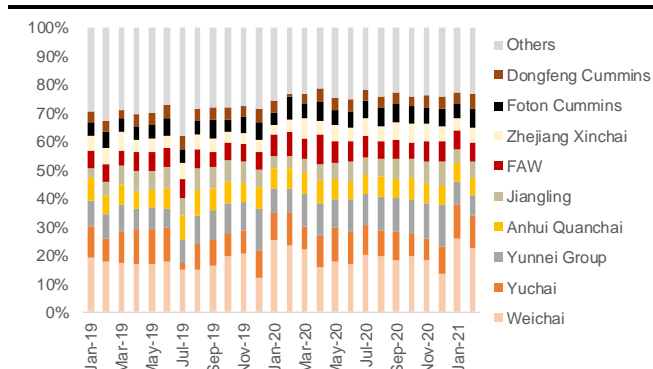
Figure 1: Weichai's quarterly results

(RMB mn)	1Q19	1Q20	Change (YoY)	2Q19	2Q20	Change (YoY)	3Q19	3Q20	Change (YoY)	4Q19	4Q20	Change (YoY)
Revenue	45,212	38,999	-14%	45,651	55,495	22%	35,846	52,889	48%	47,653	50,107	5%
Cost of sales	-35,420	-30,247	-15%	-35,681	-45,743	28%	-27,653	-42,667	54%	-37,599	-40,696	8%
Gross profit	9,792	8,752	-11%	9,969	9,752	-2%	8,193	10,222	25%	10,053	9,412	-6%
Other income	128	97	-24%	211	169	-20%	99	250	151%	330	853	158%
Other gains and losses	113	164	44%	60	120	100%	225	-163	n/a	30	-135	n/a
S&D expenses	-2,736	-2,718	-1%	-2,634	-2,595	-2%	-2,575	-2,845	10%	-3,309	-2,705	-18%
Administrative and R&D expenses	-2,560	-2,840	11%	-3,119	-3,139	1%	-2,800	-3,401	21%	-3,649	-4,342	19%
Taxes and surcharges	-189	-165	-13%	-186	-267	44%	-95	-169	78%	-194	-229	18%
Impairment loss of assets	-226	-237	5%	-226	-320	42%	-77	-120	54%	-207	-550	165%
EBIT	4,323	3,052	-29%	4,075	3,720	-9%	2,970	3,775	27%	3,053	2,303	-25%
Other expenses	-43	-40	-8%	13	-6	n/a	-22	-35	60%	-42	-61	46%
Net finance cost	-108	14	n/a	-33	-181	n/a	0	-70	n/a	-79	-43	-46%
Share of profit of JV and associates	11	22	88%	112	123	10%	19	28	48%	102	81	-21%
Pretax profit	4,183	3,049	-27%	4,167	3,656	-12%	2,967	3,697	25%	3,034	2,280	-25%
Income tax	-811	-457	-44%	-647	-546	-16%	-531	-698	31%	-456	294	n/a
After tax profit	3,373	2,592	-23%	3,520	3,110	-12%	2,436	3,000	23%	2,578	2,573	0%
MI	-781	-527	-32%	-824	-494	-40%	-666	-574	-14%	-531	-472	-11%
Net profit	2,591	2,064	-20%	2,696	2,616	-3%	1,771	2,426	37%	2,047	2,101	3%

Key ratios			Change (ppt)			Change (ppt)			Change (ppt)			Change (ppt)
Gross margin	21.7%	22.4%	0.8	21.8%	17.6%	-4.3	22.9%	19.3%	-3.5	21.1%	18.8%	-2.3
S&D expense ratio	6.1%	7.0%	0.9	5.8%	4.7%	-1.1	7.2%	5.4%	-1.8	6.9%	5.4%	-1.5
Administrative and R&D expense ratio	5.7%	7.3%	1.6	6.8%	5.7%	-1.2	7.8%	6.4%	-1.4	7.7%	8.7%	1.0
Effective tax rate	19.4%	15.0%	-4.4	15.5%	14.9%	-0.6	17.9%	18.9%	1.0	15.0%	-12.9%	-27.9

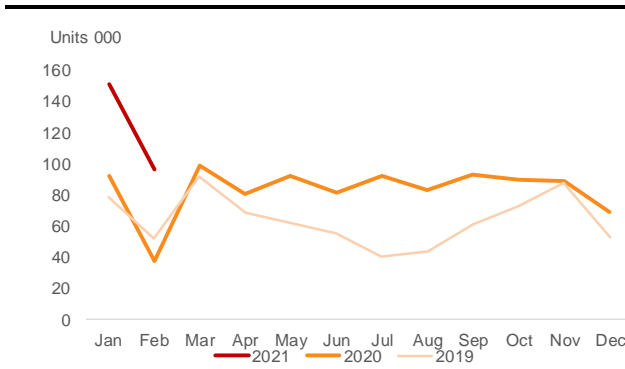
Source: Company data, CMBIS

Figure 2: China multi-cylinder engine market share



Source: CICEIA, CMBIS

Figure 3: Weichai's multi-cylinder engine monthly sales volume



Source: CICEIA, CMBIS

Figure 4: KION's latest guidance for 2021E

(EUR mn)	2019	2020	2021E guidance	
			Low-end	High-end
Order intake	9,112	9,443	9,700	10,400
Growth (YoY)	5%	4%	3%	10%
Revenue	8,807	8,342	9,150	9,750
Growth (YoY)	10%	-5%	10%	17%
Adjusted EBIT	851	547	720	800
Growth (YoY)	8%	-36%	32%	46%
Adjusted EBIT margin	9.7%	6.6%	7.9%	8.2%
Net income	445	211	-	-
Growth (YoY)	11%	-53%	-	-

Source: Company data, CMBIS

Figure 5: KION's quarterly financials

KION (EUR mn)	1Q20	2Q20	3Q20	4Q20
Order intake	2,081	2,319	2,315	2,727
Growth (YoY)	-2%	12%	-1%	6%
Revenue	2,028	1,900	2,073	2,341
Growth (YoY)	-3%	-17%	-4%	3%
Adjusted EBIT	144	61	159	183
Growth (YoY)	-21%	-73%	-27%	-19%
Adjusted EBIT margin	7.1%	3.2%	7.7%	7.8%
Net income	68	-17	82	78
Growth (YoY)	-27%	-114%	-32%	-26%

Source: Company data, CMBIS

Figure 6: Change in key assumptions

Change in key assumptions	2021E			2022E		
Sales volume (unit)	Old	New	Change	Old	New	Change
Engine total	969,828	1,072,355	10.6%	1,021,264	1,173,560	14.9%
HDT (Shaanxi Heavy-duty Motor)	178,000	177,380	-0.3%	180,000	180,928	0.5%
Gear box (Shaanxi Fast Gear Company)	1,100,000	1,304,600	18.6%	1,130,000	1,330,692	17.8%
(RMB mn)						
Revenue						
Diesel engines	64,688	69,703	7.8%	68,118	76,281	12.0%
Automobiles and major components	78,725	93,365	18.6%	80,696	95,988	18.9%
Forklift trucks & supply chain solution	69,649	72,923	4.7%	73,132	77,298	5.7%
Intersegment sales	-15,980	-17,699	10.8%	-16,646	-18,718	12.4%
Total revenue	197,082	218,291	10.8%	205,300	230,850	12.4%
Segment profit						
Diesel engines	10,156	10,595	4.3%	10,695	11,595	8.4%
Automobiles and major components	2,834	2,334	-17.6%	2,905	2,400	-17.4%
Forklift trucks & supply chain solution	4,109	4,302	4.7%	4,315	4,561	5.7%
Intersegment sales	-160	-142	-11.4%	-166	-150	-10.0%
Total segment profit	16,940	17,090	0.9%	17,748	18,405	3.7%
Segment margin		Change (ppt)			Change (ppt)	
Diesel engines	15.7%	15.2%	-0.5	15.7%	15.2%	-0.5
Automobiles and major components	3.6%	2.5%	-1.1	3.6%	2.5%	-1.1
Forklift trucks & supply chain solution	5.9%	5.9%	0.0	5.9%	5.9%	0.0
Average	8.6%	7.8%	-0.8	8.6%	8.0%	-0.7
Net profit	11,747	11,955	1.8%	12,449	12,973	4.2%

Source: Company data, CMBIS estimates

Valuation

We revise up our SOTP-based TP to HK\$27.6 from HK\$20.8. We apply proportionate market cap to value **Ballard Power Systems (BLDP CN)** and **Ceres Power (CWR LN)**, the two hydrogen fuel cell manufacturers, to better reflect the market value following the surge of share prices. Besides, we revise up our target EV/EBITDA multiple for Weichai's core business from 6x to 7.5x, above the historical average of 6.5x, to reflect the rising contribution of new business.

Figure 7: SOTP valuation

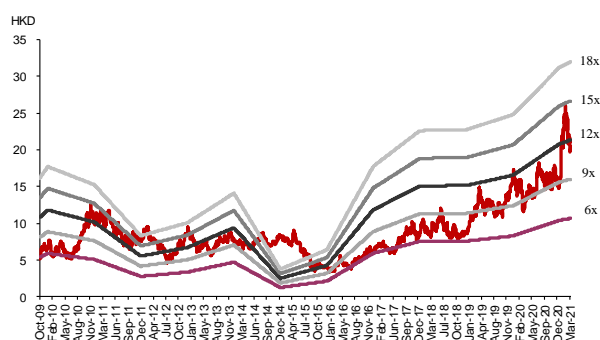
SOTP valuation	Valuation methodology	Target multiple (x)	EBITDA 2021E (RMB mn)	Estimated EV (RMB mn)	Net cash / (Net debt)	Equity value (RMB mn)
Weichai core business	EV/EBITDA	7.5	15,629	117,217	17,442	134,659
KION Group	Proportionate market value	-	-	-	-	39,514
Ballard Power Systems	Proportionate market value	-	-	-	-	9,566
Ceres Power	Proportionate market value	-	-	-	-	4,232
Share of JV/associates	P/B	2.5	-	-	-	8,796
Minority interest (Weichai core business)						-11,257
Total NAV						185,509
NAV per share (RMB)						23.4
NAV per share (HK\$)						27.6

Note 1: Weichai owns 45.2% interest in KION, 20% interest in Ballard Power and 20% interest in Ceres Power.

Note 2: Share of JV / associates exclude Ballard Power and Ceres Power

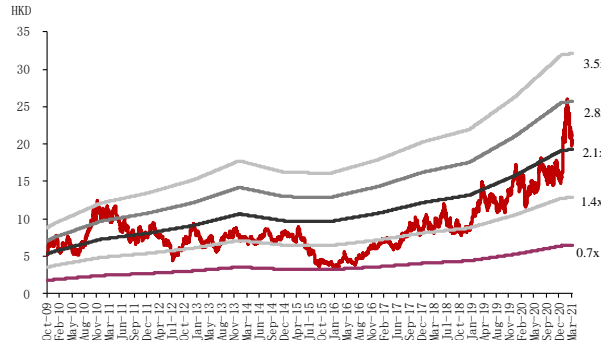
Source: Company data, CMBIS estimates

Figure 8: Weichai Power-H P/E band



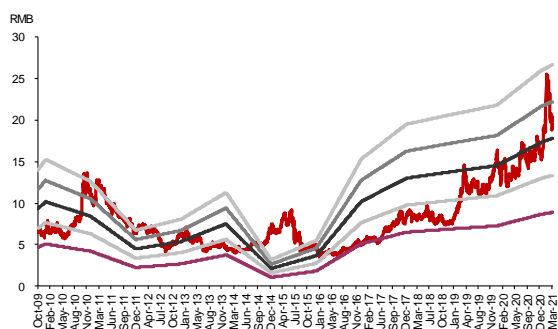
Source: Bloomberg, Company data, CMBIS estimates

Figure 9: Weichai Power-H P/B band



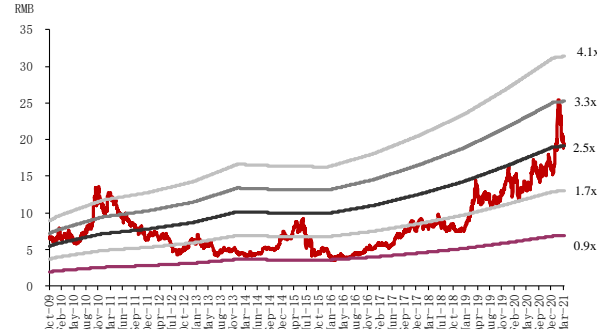
Source: Bloomberg, Company data, CMBIS estimates

Figure 10: Weichai Power-A P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 11: Weichai Power-A P/B band



Source: Bloomberg, Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue	159,256	174,361	197,491	218,291	230,850
Cost of sales	-123,686	-136,353	-159,353	-172,887	-182,833
Gross profit	35,569	38,008	38,138	45,405	48,017
Operating expenses	-21,757	-23,586	-25,289	-27,265	-28,567
EBIT	13,812	14,422	12,850	18,140	19,450
Other expenses	-52	-94	-142	-262	-277
Net finance cost	-75	-220	-279	228	491
Finance income and others	1,060	1,067	1,278	1,569	1,836
Finance expenses	-1,135	-1,288	-1,557	-1,341	-1,345
profit of JV & associates	174	244	253	250	255
Pretax profit	13,858	14,352	12,682	18,356	19,919
Income tax	-2,233	-2,445	-1,407	-3,029	-3,287
After tax profit	11,626	11,907	11,275	15,327	16,632
MI	-2,968	-2,802	-2,068	-3,372	-3,659
Net profit	8,658	9,105	9,207	11,955	12,973
D&A	7,404	8,071	8,858	7,460	8,547
EBITDA	21,216	22,493	21,708	25,600	27,997

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
Pretax profit	13,858	14,352	12,682	18,356	19,919
Finance cost	1,135	1,288	1,557	1,341	1,345
Interest income	-1,060	-1,067	-1,278	-1,569	-1,836
Share of profit or loss of associates	-174	-244	-253	-250	-255
Depreciation	5,321	6,188	6,699	5,155	6,145
Amortization of intangible assets	2,016	1,820	2,087	2,230	2,327
Income tax paid	-2,233	-2,445	-1,407	-3,029	-3,287
Change in working capital	2,363	2,603	1,114	-283	1,131
Others	1,035	1,341	1,727	1,644	1,911
Cash flow from operation	22,262	23,835	22,928	23,595	27,400
Net capex on PP&E	-1,952	-6,335	-5,992	-9,500	-10,500
Investment in JV/associates	-1,655	-243	-537	0	0
Investment in subsidiaries	0	0	-938	0	0
Dividend received	181	135	145	142	146
Others	-3,754	-1,947	-2,095	0	0
Cash flow from investing	-7,181	-8,391	-9,417	-9,358	-10,354
Proceeds from equity financing	0	0	0	0	0
Net bank borrowings	635	1,137	1,052	300	300
Dividend paid	-4,039	-4,851	-3,459	-1,190	-4,782
Interest paid	0	0	0	-1,341	-1,345
Others	-3,577	-3,853	-579	0	0
Cash flow from financing	-6,980	-7,567	-2,986	-2,231	-5,827
Change in cash	8,100	7,877	10,525	12,006	11,219
Cash at beginning of the year	34,222	38,210	48,818	62,216	74,222
Exchange gains/(losses) and others	-4,112	2,731	2,873	0	-0
Cash at the end of the year	38,210	48,818	62,216	74,222	85,441

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20A	FY21E	FY22E
Non-current assets	97,171	110,647	118,235	120,458	122,596
PP&E	29,453	26,316	31,720	34,565	37,420
Investment in JV/associates	4,464	4,711	4,944	5,052	5,162
Goodwill	23,037	23,823	24,666	24,666	24,666
Long term receivables	6,483	8,448	9,623	9,623	9,623
Intangible assets	23,299	23,436	23,826	23,096	22,269
Others	10,434	23,914	23,457	23,457	23,457
Current assets	108,105	126,185	152,515	162,877	180,866
Prepayments	1,109	997	1,095	1,020	945
Inventories	20,674	24,718	31,226	29,403	34,714
Trade receivables	13,155	14,285	15,422	15,677	17,211
Notes receivables	24,993	26,458	28,780	28,780	28,780
Others	9,964	10,910	13,775	13,775	13,775
Cash	38,210	48,818	62,216	74,222	85,441
Current liabilities	88,617	105,877	123,713	122,661	131,437
Trade and bills payables	30,869	36,749	45,450	43,599	51,575
Notes payable	15,925	22,446	22,970	22,970	22,970
Bank borrowings	12,371	15,013	17,006	17,806	18,606
Others	29,451	31,669	38,287	38,287	38,287
Non-current liabilities	54,400	61,180	66,604	66,104	65,604
Bank borrowings	23,174	21,669	20,729	20,229	19,729
Long term payables	19,475	16,325	21,205	21,205	21,205
Others	11,751	23,186	24,670	24,670	24,670
Equity	62,259	69,775	80,433	94,570	106,421
Shareholders' equity	39,314	45,224	51,202	61,967	70,159
MI	22,946	24,551	29,231	32,603	36,262

Key ratios

YE 31 Dec	FY18A	FY19A	FY20A	FY21E	FY22E
Sales mix (%)					
Diesel engines	28.2	28.7	31.8	31.9	33.0
Automobiles and major components	42.0	41.0	43.5	42.8	41.6
Forklift trucks & supply chain solution	38.0	38.5	33.0	33.4	33.5
Intersegment sales	(8.2)	(8.2)	(8.2)	(8.1)	(8.1)
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratio (%)					
Gross margin	22.3	21.8	19.3	20.8	20.8
EBIT margin	8.7	8.3	6.5	8.3	8.4
After tax profit margin	7.3	6.8	5.7	7.0	7.2
Growth (%)					
Revenue	5.1	9.5	13.3	10.5	5.8
Gross profit	7.5	6.9	0.3	19.1	5.8
EBIT	23.4	4.4	(10.9)	41.2	7.2
Net profit	27.2	5.2	1.1	29.8	8.5
Balance sheet ratio					
Current ratio (x)	1.2	1.2	1.2	1.3	1.4
Receivable turnover days	31	29	27	26	26
Inventory turnover days	60	61	64	64	64
Payable turnover days	91	91	94	94	95
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	5.9	5.4	4.4	5.5	5.7
ROE	23.2	21.5	19.1	21.1	19.6
Per share data					
EPS (RMB)	1.08	1.15	1.16	1.51	1.64
BVPS (RMB)	4.96	5.70	6.45	7.81	8.84
DPS (RMB)	0.46	0.29	0.15	0.60	0.65

Source: Company data, CMBIS estimates

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HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
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OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
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