

Jiangsu Hengli Hydraulic (601100 CH)

Earnings impressive but we are now more conservative on valuation

Hengli's net profit in 2020 came in at RMB2.25bn (+74% YoY) which is close to the high end of the profit range stated in the profit alert. Besides, net profit in 1Q21 surged 126% YoY to RMB783mn, in line with our expectation. While the results are brilliant, the revenue guidance of 15% in 2021E is conservative in our view. We slightly revise up our earnings forecast in 2021E2/22E by 1%/2% but trim our TP to RMB95 from RMB143 (based on 43x 2021E P/E, down from 65x). Our lower target valuation is to reflect a potential slowdown of excavator demand in the near term, as preliminary industry figures suggest that excavator sales growth in Apr is expected to slow to 10% for the industry as whole, versus 60% in Mar.

- **Earnings highlight in 2020.** Hengli's net profit in 2020 surged 74% YoY to RMB2.25bn, driven by 45% YoY increase in revenue, gross margin expansion by 6.3ppt YoY to 44.1% and operating leverage. In 4Q20, net profit surged 106% YoY to RMB782mn. Gross margin in 4Q20 reached an impressive level of 48% (+7.3ppt YoY). Hengli proposed final dividend of RMB0.6 per share, implying 34.7% payout ratio.
- **Solid market share gain on hydraulic cylinder for excavator.** Hydraulic cylinder sales volume grew 45% YoY to 706k units in 2020. We estimate Hengli achieved 54% market share (+3ppt YoY). Gross margin of hydraulic cylinder (including non-standardized products) expanded 7.4ppt YoY to 46.8%.
- **Explosive growth of pump and valve + strong gross margin expansion.** Sales volume of pump and valves surged 103% YoY to 137k units in 2020. The segment gross margin impressively expanded 14.4ppt YoY to 52.3%. We expect pump and valve will continue to serve as important drivers go forward.
- **Earnings highlight in 1Q21.** Net profit surged 126% YoY to RMB783mn, driven by 109% YoY increase in revenue and 3.2ppt gross margin expansion (to 41%). Net profit in 1Q21 accounted for 27% of our full year estimates (run rate in 1Q20: 15%).
- **Key risks:** (1) Slowdown of construction activities; (2) risk of overseas expansion; (3) increase in raw materials cost.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	5,414	7,855	9,298	10,650	11,779
YoY growth (%)	28.6	45.1	18.4	14.5	10.6
Net income (RMB mn)	1,296	2,254	2,897	3,452	4,006
EPS (RMB)	0.99	1.73	2.22	2.64	3.07
YoY growth (%)	54.9	73.9	28.5	19.2	16.1
Consensus EPS (RMB)	NA	NA	2.15	2.59	NA
EV/EBITDA (x)	63.5	35.2	30.8	26.6	23.6
P/E (x)	82.7	47.6	37.0	31.1	26.8
P/B (x)	19.2	14.7	11.4	9.0	7.3
Yield (%)	0.5	0.7	0.9	1.1	1.3
ROE (%)	25.6	35.0	34.6	32.4	30.2
Net debt / equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price: **RMB95.00**
 (Previous TP **RMB143.00**)
 Up/Downside: **+16%**
 Current Price: **RMB82.12**

China Capital Goods

Wayne Fung, CFA

(852) 3900 0826

waynefung@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	107,196
Avg 3 mths t/o (RMB mn)	816
52w High/Low (RMB)	137.66/45.39
Total Issued Shares (mn)	1,305

Source: Bloomberg

Shareholding Structure

WANG's family	71.0%
CCASS (Hong Kong)	10.0%
Others	19.0%

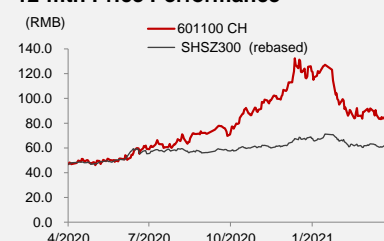
Source: Company data

Share Performance

	Absolute	Relative
1-mth	0.3%	-3.7%
3-mth	-29.0%	-22.2%
6-mth	28.4%	18.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: RSM

1. China Construction Machinery Sector – Excavator sales +60% YoY in Mar; BUY SANY Heavy & Hengli – 9 Apr 2021
2. Jiangsu Hengli Hydraulic (601100 CH) – 2020E earnings above expectations; Solid structural growth story – 22 Jan 2021
3. Jiangsu Hengli Hydraulic (601100 CH) – Solid share gain story for both short and long-term; Raise earnings est. & TP – 11 Dec 2020

Figure 1: 2020 results highlights

YE Dec 31(RMB mn)	2019	2020	Change (YoY)
Total revenue	5,414	7,855	45.1%
Cost of sales	(3,369)	(4,391)	30.3%
Gross profit	2,045	3,464	69.4%
Surcharge	(52)	(72)	38.9%
S&D expenses	(111)	(107)	-4.0%
Administrative expenses	(435)	(509)	16.9%
Asset impairment	(52)	(90)	73.7%
EBIT	1,395	2,687	92.7%
Net finance income/(cost)	31	(151)	n/a
Finance income	187	223	19.2%
Finance expenses	(156)	(375)	139.8%
Other gains/(losses)	67	74	9.7%
Share of profit of JV and associates	0	0	n/a
Pretax profit	1,493	2,609	74.8%
Income tax	(195)	(348)	78.7%
After tax profit	1,298	2,261	74.2%
MI	(2)	(7)	278.2%
Net profit	1,296	2,254	73.9%
D&A	264	311	17.7%
EBITDA	1,659	2,997	80.7%

Source: Company data, CMBIS

Figure 2: 1Q21 results highlights

(RMB mn)	1Q20	1Q21	Change YoY	2Q19	2Q20	Change YoY	3Q19	3Q20	Change YoY	4Q19	4Q20	Change YoY
Total revenue	1,369	2,857	108.7%	1,224	2,087	70.5%	1,041	1,867	79.4%	1,580	2,532	60.2%
Cost of sales	(850)	(1,684)	98.1%	(736)	(1,159)	57.6%	(674)	(1,065)	58.0%	(937)	(1,317)	40.6%
Gross profit	518	1,172	126.2%	488	928	90.0%	367	803	118.7%	644	1,215	88.8%
Other income	(13)	(30)	121.6%	(11)	(23)	111.3%	(12)	(14)	15.2%	(14)	(22)	53.9%
S&D expenses	(26)	(30)	12.2%	(29)	(29)	-0.7%	(31)	(38)	23.5%	(32)	(14)	-57.1%
Administrative expenses	(97)	(168)	72.8%	(113)	(108)	-4.3%	(104)	(115)	10.0%	(123)	(188)	53.3%
Asset impairment	(18)	(23)	22.7%	8	(24)	n/a	(1)	0	n/a	(37)	(47)	25.1%
EBIT	363	922	154.2%	344	744	116.5%	218	635	191.1%	437	945	116.0%
Net finance income/(cost)	37	(2)	n/a	50	(3)	n/a	43	(85)	n/a	(27)	(101)	279.1%
Other gains/(loss)	18	18	-2.7%	12	18	50.6%	32	28	-12.6%	10	10	-2.0%
Profit of JV & associates	0	0	n/a	0	0	n/a	0	0	n/a	0	0	n/a
Pretax profit	418	937	124.2%	405	759	87.2%	294	579	97.0%	421	853	102.8%
Income tax	(70)	(153)	118.0%	(60)	(118)	97.2%	(47)	(91)	94.3%	(41)	(68)	65.1%
After tax profit	348	784	125.4%	345	641	85.5%	247	487	97.6%	380	785	106.9%
MI	(1)	(1)	77.4%	(1)	(2)	n/a	(0)	(1)	n/a	(1)	(4)	617.5%
Net profit	347	783	125.5%	345	639	85.4%	246	486	97.3%	379	782	106.2%
Key ratios			<i>ppt</i>			<i>ppt</i>			<i>ppt</i>			<i>ppt</i>
Gross margin	37.9%	41.0%	3.2	39.9%	44.5%	4.6	35.3%	43.0%	7.7	40.7%	48.0%	7.3
S&D expense ratio	1.9%	1.0%	-0.9	2.4%	1.4%	-1.0	3.0%	2.0%	-0.9	2.0%	0.5%	-1.5
Administrative and R&D exp ratio	7.1%	5.9%	-1.2	9.2%	5.2%	-4.1	10.0%	6.2%	-3.9	7.8%	7.4%	-0.3
Effective tax rate	16.8%	16.4%	-0.5	14.8%	15.6%	0.8	16.0%	15.8%	-0.2	9.8%	7.9%	-1.8

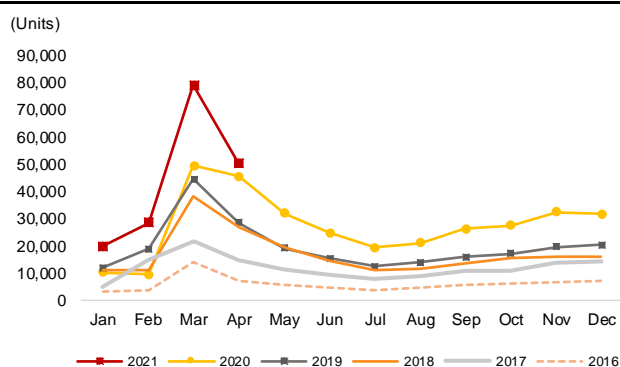
Source: Company data, CMBIS

Figure 3: Change in key assumptions

	Old		New		Change	
(RMB mn)	2021E	2022E	2021E	2022E	2021E	2022E
Revenue						
Hydraulic cylinder for excavator	3,566	3,851	3,566	3,851	0.0%	0.0%
Specialised hydraulic cylinder for heavy equipment	1,958	2,129	1,563	1,720	-20.1%	-19.2%
Hydraulic pump and valve	2,520	3,276	2,923	3,654	16.0%	11.5%
Hydraulic system	250	280	212	237	-15.2%	-15.2%
Component	782	899	1,015	1,167	29.8%	29.8%
Revenue (hydraulic business)	9,076	10,435	9,279	10,629	2.2%	1.9%
Other business	19	21	19	21	0.7%	0.7%
Total revenue	9,094	10,456	9,298	10,650	2.2%	1.9%
Gross margin						
Hydraulic cylinder for excavator	44.7%	44.5%	44.7%	44.5%	0.0	0.0
Specialised hydraulic cylinder for heavy equipment	41.0%	41.0%	41.0%	41.0%	0.0	0.0
Hydraulic pump and valve	44.0%	44.0%	46.0%	45.0%	2.0	1.0
Hydraulic system	34.0%	34.0%	35.0%	35.0%	1.0	1.0
Component	33.0%	33.0%	20.0%	25.0%	-13.0	-8.0
Gross margin (hydraulic business)	42.4%	42.4%	41.6%	41.8%	-0.8	-0.6
Other business	66.0%	66.0%	66.0%	66.0%	0.0	0.0
Average gross margin	42.5%	42.4%	41.6%	41.8%	-0.8	-0.6
					Change (ppt)	
S&D expense ratio	-1.9%	-1.9%	-1.2%	-1.1%	0.7	0.8
Admin expense and R&D ratio	-6.2%	-6.0%	-6.2%	-6.0%	0.0	0.0
Net profit	2,868	3,387	2,897	3,452	1.0%	1.9%

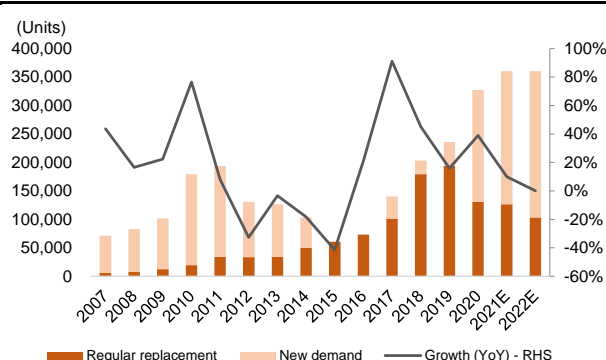
Source: Company data, CMBIS estimates

Figure 4: Excavator monthly sales volume (industry)



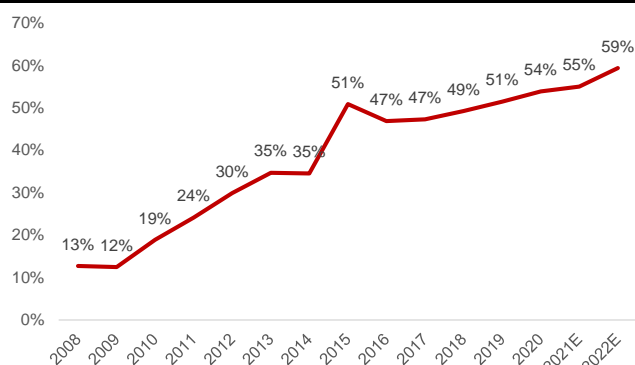
Note: Estimated figure for Apr 2021
 Source: CCMA, CMBIS estimates

Figure 5: CMBIS excavator sales projection (industry)



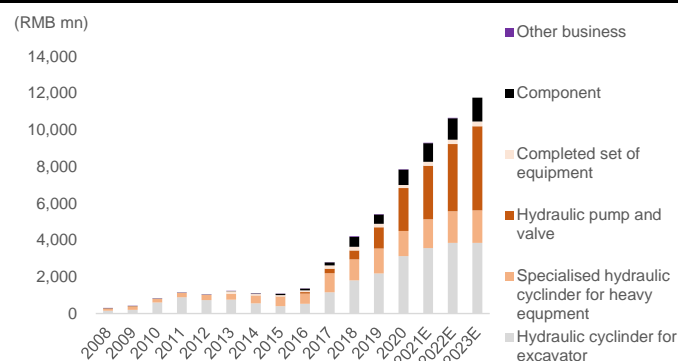
Source: Company data, CMBIS estimates

Figure 6: Hengli's market share in hydraulic cylinder for excavator



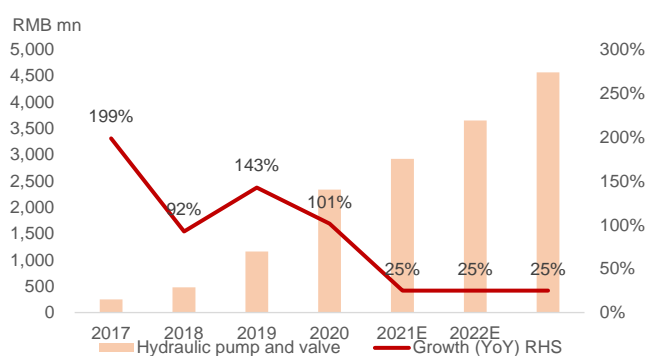
Source: Company data, CMBIS estimates

Figure 7: Hengli's revenue breakdown



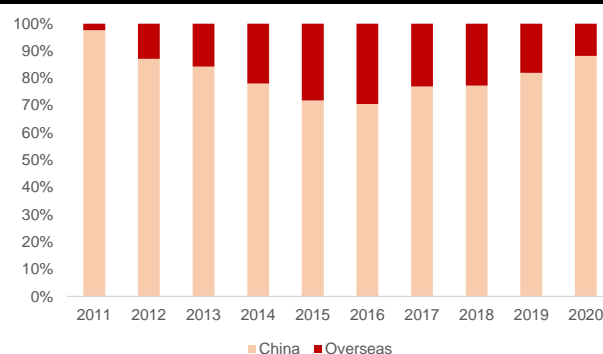
Source: Company data, CMBIS estimates

Figure 8: Hengli's revenue of pump & valves



Source: Company data, CMBIS estimates

Figure 9: Revenue breakdown by region

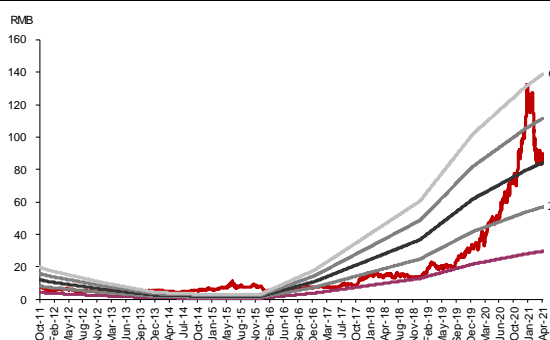


Source: Company data, CMBIS

Valuation

We continue to like Hengli's structural growth story as (1) the competitive landscape is favourable for Hengli to achieve further import substitution across different products; (2) Hengli's growth has become more structural than cyclical. That said, we trim our TP to RMB95 from RMB143 as we revise down our target P/E to 43x, making it in line with the historical average (previously 65x 2021E P/E). Preliminary figures suggest that excavator sales growth in Apr slowed to 10% for the industry as whole, versus 60% in Mar. Our more conservative multiple is to reflect the potential slowdown of excavator demand in the near term following the peak season in 1Q21.

Figure 10: Hengli's P/E band



Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	5,414	7,855	9,298	10,650	11,779
Cost of sales	(3,369)	(4,391)	(5,429)	(6,198)	(6,769)
Gross profit	2,045	3,464	3,869	4,452	5,010
Surcharge	(52)	(72)	(93)	(106)	(118)
S&D expenses	(111)	(107)	(112)	(117)	(130)
Administrative expenses	(435)	(509)	(576)	(639)	(695)
Asset impairment	(52)	(90)	0	0	0
EBIT	1,395	2,687	3,088	3,589	4,068
Net finance income/(cost)	31	(151)	234	374	537
Finance income	187	223	276	413	576
Finance expenses	(156)	(375)	(43)	(39)	(39)
Other gains/(losses)	67	74	93	106	118
Profit of JV and associates	0	0	0	0	0
Pretax profit	1,493	2,609	3,415	4,070	4,723
Income tax	(195)	(348)	(512)	(610)	(708)
After tax profit	1,298	2,261	2,903	3,459	4,015
MI	(2)	(7)	(6)	(7)	(8)
Net profit	1,296	2,254	2,897	3,452	4,006
D&A	264	311	338	369	394
EBITDA	1,659	2,997	3,426	3,958	4,462

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Pretax profit	1,493	2,609	3,415	4,070	4,723
Finance cost	(33)	146	43	39	39
Profit or loss of associates	0	0	0	0	0
Loss/(gain) on disposal	1	1	0	0	0
Depreciation & amortization	264	311	338	369	394
Income tax paid	(375)	(714)	(512)	(610)	(708)
Change in working capital	66	(849)	29	(466)	(268)
Others	253	488	0	0	0
Cash flow from operation	1,660	1,981	3,312	3,402	4,179
Net capex on PP&E	(434)	(380)	(500)	(500)	(400)
Investment in JV/associates	0	0	0	0	0
Investment in subsidiaries	0	0	0	0	0
Investment in intangibles	(4)	(19)	(20)	(20)	(20)
Dividend received	0	0	0	0	0
Others	(14)	(264)	0	0	0
Cash flow from investing	(452)	(663)	(520)	(520)	(420)
Equity financing/(repurchase)	0	0	0	0	0
Net bank borrowings	(100)	(361)	(150)	0	0
Dividend paid	(265)	(529)	(783)	(1,014)	(1,208)
Interest paid	(107)	(40)	(43)	(39)	(39)
Others	18	112	0	0	0
Cash flow from financing	(454)	(818)	(976)	(1,053)	(1,247)
Change in cash	754	499	1,816	1,829	2,512
Cash at beginning of the year	1,571	2,343	2,777	4,593	6,422
Exchange and others	18	(66)	0	0	0
Cash at the end of the year	2,343	2,777	4,593	6,422	8,934

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	2,935	3,025	3,207	3,358	3,384
PP&E	2,364	2,432	2,608	2,753	2,774
JV/associates	0	0	0	0	0
Goodwill	0	0	0	0	0
Intangible assets	273	280	286	292	297
AFS investments	0	0	0	0	0
Others	257	261	261	261	261
Deferred tax assets	41	52	52	52	52
Current assets	5,492	7,595	9,501	12,082	14,832
Inventories	997	1,217	1,520	1,537	1,838
Trade and bill receivables	1,639	2,705	2,492	3,227	3,163
Prepayment	98	164	164	164	164
Others	414	733	733	733	733
Pledged deposits	0	0	0	0	0
Cash	2,343	2,777	4,593	6,422	8,934
Current liabilities	2,170	2,590	2,608	2,895	2,865
Trade and bill payables	791	1,131	1,249	1,536	1,506
Bank borrowings	937	554	454	454	454
Tax payable	62	119	119	119	119
Advance from customers	192	108	108	108	108
Others	188	677	677	677	677
Non-current liabilities	643	679	629	629	629
Bank borrowings	200	370	320	320	320
Deferred tax liabilities	70	108	108	108	108
Deferred income	223	200	200	200	200
Others	150	0	0	0	0
Equity	5,614	7,352	9,471	11,917	14,723
Shareholders' equity	5,584	7,314	9,427	11,866	14,664
MI	30	38	44	51	59

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Cylinder for excavator	40%	40%	38%	36%	33%
Cylinder for heavy equipment	25%	17%	17%	16%	15%
Hydraulic pump and valve	21%	30%	31%	34%	39%
Hydraulic system	3%	2%	2%	2%	2%
Component	9%	11%	11%	11%	11%
Other business	0%	0%	0%	0%	0%
Total revenue	100%	100%	100%	100%	100%
Profit & loss ratio (%)					
Gross margin	37.8	44.1	41.6	41.8	42.5
EBIT margin	25.8	34.2	33.2	33.7	34.5
Net profit margin	24.0	28.8	31.2	32.5	34.1
Growth (%)					
Revenue	28.6	45.1	18.4	14.5	10.6
Gross profit	32.7	69.4	11.7	15.1	12.6
EBIT	58.7	92.7	14.9	16.2	13.4
Net profit	54.9	73.9	28.5	19.2	16.1
Balance sheet ratio					
Current ratio (x)	2.5	2.9	3.6	4.2	5.2
Receivable turnover days	100	101	102	98	99
Inventory turnover days	111	92	92	90	91
Payable turnover days	80	80	80	82	82
Net debt / total equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Profitability (%)					
ROA	16.5	23.7	24.8	24.5	23.8
ROE	25.6	35.0	34.6	32.4	30.2
Per share data					
EPS (RMB)	0.99	1.73	2.22	2.64	3.07
BVPS (RMB)	4.28	5.60	7.22	9.09	11.23
DPS (RMB)	0.41	0.60	0.78	0.93	1.07

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
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
NOT RATED	: Stock is not rated by CMBIS
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.